IMPROVING INCENTIVES FOR VENTURE CAPITAL INVESTMENT

The Government will promote investment in innovative Australian firms by providing certain capital gains tax exemptions for Australian superannuation funds and non-resident tax-exempt pension funds.

Australian widely-held superannuation funds will be provided with an exemption where they receive income from a Pooled Development Fund (PDF) representing gains on the disposal of eligible venture capital investment. Non-resident tax-exempt pension funds from certain countries will be exempt from income tax, including capital gains tax, on gains derived from the disposal of investments in new equity in eligible venture capital investments.

Key features

Australian superannuation funds

- Franked dividends received from a PDF, in relation to capital gains on an eligible venture capital investment, will be exempt from tax and the superannuation fund will be entitled to a refundable imputation credit (unfranked dividends are already exempt).

Non-resident tax-exempt pension funds

- Non-resident pension funds that are tax-exempt in their home jurisdiction will be exempt from income tax on the disposal investments in new equity in eligible venture capital investments.
- The investee entity must not have gross assets exceeding $50 million.
- Investment in real estate and other passive investments will be excluded from the exemption.
- The exemption will only apply to investments which are at risk and held by the investor for at least 12 months.
- The effectiveness of the measure is to be reviewed five years after introduction.

Further details are provided in the appendix to this attachment.

Commencement

The measure commences on the date of Royal Assent of the legislation.

Current arrangements

Australian superannuation funds are currently encouraged to invest in venture capital through the PDF program. Superannuation funds are exempt from tax on the disposal of an interest in a PDF, but are affected by tax paid by the PDF on the disposal of venture capital investments.

Foreign tax-exempt pension funds may be subject to tax in Australia on the disposal of interests in venture capital investments while they face no tax on the disposal of these investments in their home country or in many other countries.

Why change is needed

These changes will help domestic firms that may face difficulties in raising significant new capital, especially for innovative ventures.

Removal of the tax on Australian superannuation funds where they use PDFs to invest in venture capital will further encourage these funds to make these investments. By providing this incentive through the superannuation system, the benefits will contribute to the retirement income of all Australians. Ensuring that non-resident tax-exempt pension funds will not be subject to tax on the disposal of interests in venture capital investments will remove the impediment to their investment in Australian venture capital.

Appendix to Attachment H

Improving Incentives for Venture Capital Investment — Further Details

Key design features

Australian superannuation funds

- Pooled Development Funds (PDFs) can invest in new equity in companies that do not have total assets exceeding $50 million, excluding companies whose primary activity is retailing or property development.
- Where PDFs derive gains on the disposal of equity investments, they are subject to tax at a rate of 15 per cent. These profits can be distributed as a partially franked dividend. Under the measure, superannuation funds receiving dividends, in relation to gains on the disposal of equity investments, will be able to treat these dividends as tax exempt and will receive a refundable credit for tax paid by the PDF.
- The exemption will be available to complying Australian superannuation funds with the exception of those with fewer than five members.

Non-resident tax-exempt pension funds

- The measure will exempt from income tax any profit or gain made from the disposal or other realisation of new equity in eligible venture capital projects.
  - If it is a disposal of a capital gains tax asset, any capital gain or capital loss will be disregarded.
  - If it is a disposal of a revenue asset, any profit or loss will disregarded.
- The investee entity must not have gross assets exceeding $50 million.
- Investment in real estate and other passive investments will be excluded from the exemption.
  - This means that the investee entity will not be an eligible investment entity if its predominant purpose is passive investment.
- The measure will initially apply to exempt pension funds from the United States, the United Kingdom, Japan, Germany, France and Canada.
  - It will be necessary for non-resident pension funds to demonstrate that they are exempt in their home jurisdiction.
  - The list of eligible jurisdictions will be expanded in due course with the date of effect specified in amending legislation and will be subject to the criterion that other jurisdictions exempt only bona fide retirement pension funds.
- The exemption will only apply to investments which are at risk and held by the investor for at least 12 months.
  - The exemption will not be available where the investor enters into an arrangement whereby its investment is protected or guaranteed in some way.

- Partnerships of exempt foreign pension funds from the approved jurisdictions, even if all the partners are not resident in the same jurisdiction, will also qualify for the exemption provided that all of the funds involved are tax-exempt in their home jurisdiction. In the case of limited partnerships, all the partners will be required to be tax-exempt pension funds with the exception of the managing partner.

- Investors wishing to benefit from the exemption will be required to register with and provide information to the Pooled Development Fund Board at the commencement of their investment and in annual returns indicating, for example, the amount invested and distributions made.