<u>Wilson Asset Management</u>

Mr Jesse Hamilton, Chief Financial Officer

Questions on notice: (Senator Bragg):

How will this new tax affect venture capital investment?

Response (provided Wednesday 1 May 2024):

One of venture capital's unique investment characteristics is its need for repeat equity injections over time as the new product or concept develops and gains traction. It's a norm that you have a series of financings (seed, series A, B, C etc) as the Company or product develops and grows. More than any other asset class, venture capital requires its investors to be prepared to commit to not just having patient long term capital but the appetite and ability to commit additional capital to ensure the survival of the start-up.

Unlike most other asset classes, start-ups tend to only have venture capital equity as its sole source of funding as start-ups have no access to debt, and do not generate positive operating cashflow while in early growth stages. Its total reliance on equity as a source of funding means that any contraction in its pool of capital will have a disproportionate impact on the health of the industry.

Venture capital investments are highly illiquid meaning individual investors have no liquidity option for their investments until the start-up reaches maturity, which may not happen for many years. There is also no established secondary market for venture capital investments. While one has options to liquidate an investment in listed shares, bonds or real estate, venture capital investors often have to wait until the start-ups list for an initial public offering (IPO) before they have the ability to monetise their investments.

The proposed tax on superannuation balances over $3 million, particularly the taxation of unrealised capital gains, is poised to substantially influence venture capital investment (and lead to Australia no longer being an appealing place to innovate). These points collectively suggest that the new tax measure could lead to a contraction in venture capital funding, particularly affecting start-ups and innovative projects that rely on patient, long-term capital. The tax policy's approach to unrealised gains not only disrupts traditional investment strategies but also poses a significant barrier to the very type of investments that drive technological advancement and economic growth.

Our key concerns include:

- Disincentive for long-term investment: The tax introduces a strong disincentive against long-term investments in start-ups, as investors in superannuation funds (particularly SMSFs) might face substantial tax liabilities on the unrealised gains of these companies, which typically do not yield (cash) returns for many years. For example, investors in a start-up like Canva, which grew substantially in valuation over time, would have faced enormous tax burdens long before any returns were materialised.
- Altered investment strategies: Venture capitalists and SMSF investors might shift away from long-term and illiquid investments to avoid premature liquidation needed to meet tax obligations. This strategic shift could deplete patient capital necessary for significant returns to be achieved in venture capital opportunities.
- Reduced capital availability: introducing this new tax in its current form, impacting superannuation funds and forcing them to divest or look elsewhere for returns could

diminish the pool of venture capital available, as these investors may redirect funds to less risky or more liquid assets, adversely affecting available funding for start-ups.

- Liquidity issues and forced sales: The mismatch between tax liabilities and actual cash flow can force investors to sell assets at inopportune times, potentially at a loss, known as 'fire sales'. This could undermine investment returns and lead to inequitable outcomes.
- Adverse effects on superannuation goals: The need to liquidate assets to fund tax liabilities on unrealised gains could disrupt long-term retirement planning, contrary to the core objective of superannuation.
- Potential for inequitable outcomes: Asset sales to meet tax liabilities could affect all fund members, not just those above the $3 million threshold, potentially harming members with lower balances. Whilst there is a need to maintain certain liquidity within a superannuation fund, the imposition of tax on unrealised gains, in the case of a venture capital investment that increases in value over time, might force investors to sell other liquid assets in the superannuation fund in order to pay the tax on unrealised gains on the venture capital investment which does not have an active market in order to dispose of the asset to fund the tax liability. This can lead to poor outcomes for superannuation members, especially in circumstances where they may never actually realise the unrealised gain that they have had to pay tax on.