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Tax Laws Amendment (2007 Measures No. 2) Bill 2007

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Contents

Tax Laws Amendment (2007 Measures No. 2) Bill 2007

Date introduced: 29 March 2007

House: House of Representatives

Portfolio: Treasury

Commencement: The Act commences on Royal Assent. The commencement and application of the Schedules are dealt with in the Main Provisions section of this Bills Digest.

Purpose

The Tax Laws Amendment (2007 Measures No. 2) Bill 2007 (the Bill) has eight Schedules and the purpose of each Schedule is briefly as follows.

- **Schedule 1** proposes to make amendments to the *Income Tax Assessment Act 1997* (ITAA 1997) so that the treatment of mining rights under the uniform capital system, which was enacted from 1 July 2001, will be more closely aligned with that of other depreciating assets. A new rule will clarify how to work out the life of a mine.

  The amendments will apply to assessments for the income year in which 1 July 2001 occurred and later income years.

- **Schedule 2** proposes to make amendments to the ITAA 1997 so that taxpayers, who cannot claim deductions in respect of their boating activities on the basis that they are carrying on a business, will be allowed to claim deductions up to the amount of their boating income. Such taxpayers could carry forward deductions in excess of their boating income and be allowed to deduct them from income from boating activities in later income years.

- **Schedule 3** proposes to make amendments to the provisions of the *Income Tax Assessment Act 1936* (ITAA 1936) dealing with the tax treatment of expenditure on research and development. As stated in paragraph 3.1 on page 29 of the Explanatory Memorandum to the Bill, these amendments clarify and make 10 technical amendments to the provisions for the premium incremental concession and the refundable tax offset. The most significant changes are that:

  – companies will now be able to claim the R&D Tax Offset if they have incurred contracted expenditure to a Registered Research Agency, regardless of whether the aggregate expenditure is less than $20 000, and

  – the premium incremental concession will be distributed amongst all companies in a group that have increased their R&D expenditure over the average of their past three year's expenditure.

- **Schedule 4** proposes to make amendments to the ITAA 1997 to allow taxpayers a tax deduction for donations of small parcels of shares in a listed public company to a deductible gift recipient (DGR). The conditions for deductibility would be that the shares were acquired at least 12 months before the donation and have a market value of $5 000 or less on the day the donor makes the gift.
- **Schedule 5** proposes amendments to the ITAA 1997 to update the list of DGRs to include the American Australian Association Limited with effect from 14 November 2006 and Bunbury Diocese Cathedral Rebuilding Fund with effect from 19 December 2006.

  Schedule 5 also extends the period for making donations to The Finding Sydney Foundation from 27 August 2006 to 28 August 2007.
- **Schedule 6** proposes amendments to the ITAA 1997 in relation to the conditions for claiming deductions for contributions to fund-raising events of DGRs.

  Under the proposed amendments the deduction will be available if:

  – the value of the contribution is more than $150 (currently it is $250), and

  – the minor benefits received by the donor is the lower of:

    (a) an amount which is less than $150 (currently it is $100), and

    (b) 20 per cent (currently 10 per cent) of the value of the contribution.
- **Schedule 7** proposes amendments to correct defects in the definitions of:

  – 'exempt entity' in the ITAA 1997, and

  – 'excepted trust' in the ITAA 1936.
- **Schedule 8** proposes amendments to the venture capital provisions in income tax law, the *Venture Capital Act 2002* and the *Pooled Development Funds Act 1992* to enhance the attraction to invest in venture capital in Australia.

  – **Part 1** of Schedule 8 includes proposed amendments to the ITAA 1997 and the *Venture Capital Act 2002* to relax the eligibility requirements for concessional taxation treatment for foreign residents investing in venture capital limited partnerships (VCLP) and Australian venture capital funds of funds (AFOFs).

  – **Part 2** of Schedule 8 includes proposed amendments to the ITAA 1936, the ITAA 1997 and the *Venture Capital Act 2002* to provide tax concessions for Australian residents and foreign residents investing in early stage venture capital activities through a new investment vehicle called the early stage venture capital limited partnership (ESVCLP).

  – **Part 3** of Schedule 8 includes proposed amendments to the ITAA 1997, the *Pooled Development Funds Act 1992* and the *Venture Capital Act 2002* to replace the name of the Pooled Development Funds (PDF) Registration Board with the name Venture Capital Registration Board. The amendments proposed also provide for the Venture Capital Registration Board to register and monitor the compliance of ESVCLPs with approved investment plans.

- **Part 4** of Schedule 8 provides for the closure of the PDF regime under the *Pooled Development Funds Act 1992* after the commencement of this Act.
- **Part 5** of Schedule 8 include technical amendments to ensure that eligible partners in conditionally registered VCLPs and AFOFs are entitled to the tax exemption on the profits and gains derived by the partnership while the partnership was conditionally registered.

Background

As there is no central theme to the Bill, the background to the various measurers and the related main provisions will be considered under the amendments proposed by each Schedule.

Schedule 1—Effective life provisions

Background

Division 40 of the ITAA 1997, which was enacted with effect from 1 July 2001, provides for a uniform capital allowance (UCA) system. The UCA is intended to allow deductions to taxpayers for the decline in value of a depreciating asset used in producing income when assessing their taxable income. A depreciating asset is an asset that has a limited effective life and that is reasonably expected to decline in value over the time it is used to produce income.

Broadly, the effective life of a depreciating asset is the period it can be used to produce income. Section 40-100 of the ITAA 1997 provides that the Commissioner of Taxation may make a written determination specifying the effective life of depreciating assets. Section 40-95 gives a taxpayer the choice to use an effective life determined by the Commissioner or to work out the effective life of the asset in accordance with section 40-105.

One of the exceptions to the above mentioned general provisions of the UCA is that in respect of the effective lives of certain intangible depreciating assets including patents, designs, copyrights and mining, quarrying or prospecting rights. Subsection 40-95(7) sets out a table giving the effective lives of certain intangible assets including certain mining, quarrying or prospecting rights in existing items 11 to 13 in the table. The provisions relating to self-assessment of effective life of depreciating assets is therefore not available in respect of these intangible assets.

Proposal to allow self-assessment of the effective life of mining, quarrying or prospecting rights

On 9 May 2006, in connection with the 2006 Budget, the Minister for Revenue and Assistant Treasurer announced that changes will be made to the way effective lives of certain mining, quarrying or prospecting rights are worked out under the UCA system so that the provisions relating to self-assessment will apply.[1] The Minister stated as follows.

> As a result of this measure, the law will include these rights under the general provisions of the uniform capital allowances regime which will provide holders of these rights with the option of self assessment; allowing them to write-off their right over the *remaining* life of the mine, petroleum field or quarry. Also, they will not be required to make an annual estimate of their asset's economic life.
>
> This measure will ensure that these rights are essentially treated the same as other depreciable assets that are written-off under the uniform capital allowances regime, as had been originally intended.

The Minister also announced that the legislative amendments will apply from 1 July 2001 — the date mining rights were brought into the UCA regime as depreciating assets.

Main provisions

Item 1 of **Schedule 1,** repeals items 11, 12 and 13 of the table in subsection 40-95(7) referred to above so that the current provisions cease to apply to determining the effective life of mining, quarrying or prospecting rights.

Item 3 of **Schedule 1** inserts **proposed subsection 40-95(10)** which includes the following table for determining the effective lives of the mining, quarrying or prospecting rights mentioned therein.

Item	For this asset:	Estimate the period until the end of:
1	A *mining, quarrying or prospecting right relating to *mining operations (except obtaining *petroleum or quarry materials)	The life of the mine or proposed mine to which the right relates or, if there is more than one, the life of the mine that has the longest estimated life
2	A *mining, quarrying or prospecting right relating to *mining operations to obtain *petroleum	The life of the petroleum field or proposed petroleum field to which the right relates
3	3 A *mining, quarrying or prospecting right relating to *mining operations to obtain quarry materials	The life of the quarry or proposed quarry to which the right relates or, if there is more than one, the life of the quarry that has the longest estimated life

Section 40-105 provides for taxpayers to self-assess effective lives of depreciating assets. Section 40-110 enables taxpayers to choose to recalculate effective lives if the effective life a taxpayer has been using is no longer accurate because of changed circumstances relating to the nature of the use of the asset. However subsection 40-105(4) and subsection 40-110(5) state that section 40-105 and section 40-110 do not apply to an intangible depreciating asset to which an item in the table in subsection 40-95(7) applies.

Item 4 of **Schedule 1** proposes to repeal subsection 40-105(4) and substitute **proposed subsection 40-105(4)**. **Item 5** inserts **proposed subsections 40-110(3A)** and **(3B)**. These proposed amendments have the effect of making a special provision in **proposed subsection 40-110(3B)** for enabling taxpayers to recalculate the effective life of a mining, quarrying or prospecting right from a later income year, if the effective life a taxpayer has been using is no longer accurate because of changed circumstances relating to an existing or proposed mine, petroleum field or quarry to which that right relates.

Proposed paragraph 40-110(4)(b) provides that the recalculation of a mining, quarrying or prospecting right must be done using the rules in **proposed subsections 40-95(10)** and **(11)**.

Financial impact

The Explanatory Memorandum to the Bill at page 3 states that the financial impact is nil.[2]

Application

Item 7 of **Schedule 1** provides that the amendments made by this Schedule apply to assessments for the income year in which 1 July 2001 occurred and later income years. Although, this measure is retrospective in its application, some taxpayers may benefit from being able to recalculate the effective life of certain mining, quarrying and prospecting rights.

Schedule 2—Taxation of boating activities

Background

On 9 May 2006, in connection with the 2006 Budget, the Minister for Revenue and Assistant Treasurer announced that the Government will amend the tax treatment of boat hire arrangements to allow taxpayers, who cannot demonstrate that they are actually carrying on a business using a boat, to claim deductions for costs related to their boating activity.[3] The Minister added that:

> The measure will allow taxpayers who cannot demonstrate that they are carrying on a business using a boat to:

– deduct expenditure relating to their boating activity up to the level of income generated from their boating activity; and

– allow any excess deductions to be carried forward and deducted against income from that boating activity in future years.

The measure will ensure that where taxpayers generate an income stream using their boat, they are not unfairly taxed while maintaining the restrictions on using the tax system to subsidise private use of boats.

Main provisions

Part 1 of **Schedule 2** includes the main amendments to the ITAA 1997 to give effect to Government's proposal. Part 2 of **Schedule 2** deal with consequential amendments.

Item 1 of **Part 1, Schedule 2** inserts **proposed section 26-47** to the ITAA 1997 to deal with non-business boating activities.

Quarantining of non-business boating activity losses

Proposed subsection 26-47(2) provides that so much of the amounts relating to using or holding boats for an income year as exceed the assessable income from using or holding boats for that year:

- were not deductible against other income for that income year; and
- were an amount (a quarantined amount) relating to using or holding boats to be deducted from assessable income from using or holding boats in the next income year.

Proposed subsection 26-47(2) clearly allows the grouping of activities from more than one boat owned by the taxpayer. The quarantined amount is the excess of the total expenditure in operating all boats over the assessable income from all boats owned by the taxpayer.

Exception for business use of boats

Proposed subsection 26-47(3) provides an exception to **proposed subsection 26-47(2)** where the using or holding of boats is attributable to one or more of the following:

- where the holding of a boat is trading stock of a taxpayer;
- where the boat is used or held for letting on hire in the ordinary course of business;
- where the boat is held or used for transporting the public or goods for payment in the ordinary course of business; and
- where using a boat is for a purpose that is essential to the efficient conduct of a business carried on by the taxpayer.

A note to **proposed subsection 26-47(3)** states that even if this exception applies, to the application of quarantining losses under **proposed subsection 26-47(2)**, Division 35 of the ITAA 1997 which deals with the deferral of losses from non-commercial business activities may still apply to quarantine losses from using or holding boats. Briefly, the quarantining of losses under Division 35 will not apply if an activity passes one of four tests, i.e. the real property test, profits test, other assets test, or assessable income test or the Commissioner exercises discretion to allow the loss to be offset against other income. An overview of the operation of the non-commercial loss provisions is to be found in the Australian Taxation Office fact sheet, a link to which is here.

Proposed subsection 26-47(6) provides that any amount quarantined under **proposed subsection 26-47(2)** can be deducted from the excess of assessable income from boating activities over the deductions from boating activities for a subsequent year. The deduction of the quarantined amount is limited to the lesser of that excess and the remaining quarantined amount.

Exception where the using or holding of a boat results in a fringe benefit

Proposed subsection 26-47(4) provides that the rule for quarantining losses under **proposed subsection 26-47(2)** does not apply to an amount incurred by using or holding a boat in providing a fringe benefit under the *Fringe Benefits Tax Assessment Act 1986* (FBTAA 1986).

Modification of quarantining rules if there is a capital gain from a boat

Item 4 of **Schedule 2** inserts **proposed section 118-80** into Subdivision 118-A of the ITAA 1997 to provide for the reduction of a capital gain in relation to a boat by an amount quarantined under **proposed subsection 26-47(2)**.

Proposed subsection 26-47(5) reduces the quarantined amount under proposed subsection 26-47(2) by so much of that quarantined amount that has been set off against the capital gain from a boat under **proposed section 118-80.**

Proposed subsection 26-47(5) also provides that the reduction from boat capital gains under **proposed subsection 26-47(5)** will take place before a deduction is made under **proposed subsection 26-47(6)** from boat business profits.

Modification of quarantining rules if there is exempt income

Section 6-20 of the ITAA 1997 states that, an amount of ordinary income or statutory income is exempt income, if it is made exempt from income tax by a provision of the ITAA 1997 or another Commonwealth law.

The method of calculating 'net exempt income' is set out in section 36-20 of Division 36 of the ITAA 1997. It is the excess of exempt income from all sources over the sum of non-capital expenses incurred in deriving that income and any foreign tax on that income. For an Australian resident, the net exempt income is the amount by which the total of:

> The net exempt income reduces the amount of tax loss for an income year as well as tax losses in a later income year under section 36-10 and 36-15 of the ITAA 1997 respectively.

Division 35 of the ITAA 1997 dealing with deferral of losses from non-commercial business activities provides that net exempt income which has not been utilised under sections 36-10 and 36-15 is set off against non-commercial losses under Division 35 before being carried forward to later income years.

> **Proposed subsection 26-47(8)** provides for the reduction of any remaining quarantined amount, after it has been reduced by any boating gains under **proposed subsection 26-47(5)** and any boat business profits under **proposed subsection 26-47(5),** by exempt income which has not been set off against carry-forward amounts from Division 35 and Division 36.

Modification of quarantining rules in the event of bankruptcy

When a taxpayer is bankrupt any losses incurred prior to bankruptcy cannot be carried forward to a period after bankruptcy as provided for in Subdivision 36-B of the ITAA 1997. There is a similar provision in Division 35 relating to non-commercial losses.

The **proposed subsections 26-47(9**) and **(10)** make a similar exception to the utilisation of quarantined amounts on bankruptcy.

Financial impact

The Explanatory Memorandum to the Bill at page 3 states that these measures will result in the following savings to revenue.

2006-07	2007-08	2008-09	2009-10
	-$5m	-$6m	-$6m

Application

Item 18 of **Part 3** of **Schedule 2** provides that the amendments made by this **Schedule** apply to the first income year starting on or after the day on which this Act receives the Royal Assent and later income years.

Schedule 3—Research and development

Background

Budget Measures 2006-07, Budget Paper No. 2 at page 319, stated that Government will improve the operation of the research and development (R&D) provisions to clarify the law, remove unintended consequences and ensure that the law reflects the original policy intent.

The Budget measure envisaged changes to the R&D tax offset leading to additional R&D tax offset payments of $7.0 million per year.

Improvements were also foreshadowed to the 175 per cent premium R&D deduction in Budget Paper No.2 as follows.

> These changes include:
>
> – ensuring that the deduction can be allocated to those companies in a group who have increased their R&D expenditure over three years; and
>
> – that the deduction requirement test matches group history and group expenditure, adding a reference to the Commercial Ready Program.

These changes will result in decreased revenue of $2.5 million per year.

Main provisions

The Explanatory Memorandum to the Bill states concisely at paragraph 3.5 on page 29 the 10 technical amendments that Schedule makes. These are set out below:

> 3.5 The new law makes 10 technical amendments to the R&D provisions of the ITAA 1936 to:
> extend the appeal and review rights to encompass companies claiming the R&D tax offset;
> extend the time for claiming the R&D tax offset;
> ensure that the exception to the $20,000 minimum R&D spend rule applies to the R&D tax offset;
> ensure that all R&D companies are covered by the R&D offset provisions by referring to ‘persons’ rather than ‘taxpayers’;
> correct a section reference;
> provide a more appropriate allocation of the premium incremental concession between companies in a group;
> match the group’s history with its R&D expenditure;
> replace a reference to the start grant with a reference to the Commercial Ready program;

provide a more appropriate outcome in calculating the amounts relevant to the premium incremental concession; and

include a reference to the premium incremental concession as a deduction in section 12-5 of the Income Tax Assessment Act 1997 (ITAA 1997).

The main provisions section of this Bills Digest will consider the significant amendments the R&D tax offset and the 175 per cent premium R&D deduction.

Significant amendments affecting the R&D tax offset

Eligible small companies with an annual group turnover of less than $5 million are entitled to choose a R&D tax offset under subsection 73I (2) of the *Income Tax Assessment Act 1936* (ITAA 1936) in the company's return of income for the tax offset year, instead of the R&D tax deduction if they satisfy the eligibility conditions in section 73J. The other conditions for eligibility for the R&D tax offset under subsection 73J(1) are that the aggregate R&D amount is more than $20 000 and less than $1 million per year. Eligible companies can choose to receive the R&D tax offset of 30 cents for each dollar of R&D expenditure that would otherwise have been claimable as a R&D deduction.

The significant amendments dealt with in this section of the Bills Digest cover the operation of the R&D tax offset.

Companies will be able to object to written notices from the Commissioner of Taxation if dissatisfied with the R&D tax offset allowed

Subsection 175A(2) of the ITAA 1936 provides that a taxpayer with no taxable income or who has taxable income but no tax payable cannot object to an assessment unless it results in an increase in the tax liability. A taxpayer who claims the tax offset and falling into one of these two categories will therefore not be able to object to an assessment in relation to the amount of tax offset included in the assessment.

Item 3 of **Schedule 3** inserts **proposed section 73IA** to provide for the Commissioner to give a company eligible for the R&D tax offset a written notice under **proposed subsection 73IA(1)** specifying the amount of tax offset available to the company under section 73I.

Proposed subsection 73IA(2) provides that the eligible company if dissatisfied with the notice may object in the manner set out in Part IVC of the *Taxation Administration Act 1953*. **Item 22** of **Schedule 3** inserts **proposed paragraph 14ZW(1)(bc)** into Part IVC to allow companies between two and four years to lodge an objection with the Commissioner depending on the complexity of their tax affairs based on the status of the company as determined by reference to the items in the table in subsection 170(1) of the ITAA 1936.

Item 4 of **Schedule 3** provides that that the amendments made by **item 3** apply on or after 1 July 2001. It must be noted that the R&D tax offset under section 73I commenced from the income year starting from 1 July 2001 and later income years. The retrospective application of this measure will assist companies to seek an amendment of the R&D tax offset with effect from the year 2001-02 income year and later years.

Companies will be able to choose the R&D tax offset by notice in writing to the Commissioner in addition to making an election in their tax returns

Under current law a company cannot choose the R&D tax offset by amending their original return. An eligible company can only claim the R&D tax offset in the company's return for the tax offset year under subsection 73I(2) of the ITAA 1936.

Item 2 of **Schedule 3** repeals subsection 73I(2) and substitutes **proposed subsection 73I(2)** to enable a company to make the election for the R&D tax offset additionally by notice in writing to the Commissioner under **proposed paragraph 73I(2)(b)** within the normal time for amendment of income tax assessments by the Commissioner. This period is determined by reference to the table in subsection 170(1) of the ITAA 1936.

Companies will be able to claim the R&D tax offset on expenditure less than $20,000 contracted to a Registered Research Agency

One of the eligibility conditions for claiming the R&D tax offset is that the aggregate R&D development amount must exceed $20 000 for the tax offset year under paragraph 73J(1)(b). **Item 5** of **Schedule 3** repeals paragraph 73J(1)(b) and substitutes **proposed paragraph 73J(1)(b)** which allows either contracted expenditure without any specified minimum amount or its aggregate research and development amount which exceeds $20 000 for the tax offset year. Contracted expenditure as defined in subsection 73B(1)means expenditure contracted to a body registered under section 39F of the *Industry Research and Development Act 1986*.

Item 6 of **Schedule 3** provides that the amendment made by **item 5** applies to expenditure incurred in years of income commencing on or after the day on which this Act receives the Royal Assent.

Financial impact

The Explanatory Memorandum at page 4 states that the changes to the R&D tax offset will cost an additional $7 million a year in R&D tax offset payments.

Application

As mentioned above:

- **item 4** of **Schedule 3** provides that that the amendments made by **item 3** relating to objections to the notice of R&D tax offset issued by the Commissioner, apply on or after 1 July 2001. It must be noted that the R&D tax offset under section 73I commenced from the income year starting on 1 July 2001.

- **item 6** of **Schedule 3** provides that the amendment made by **item 5** relating the R&D tax offset on contracted expenditure with a Registered Research Agency, applies to expenditure incurred in years of income commencing on or after the day on which this Act receives the Royal Assent.

As the table in **clause 2** of the Bill provides that **Schedule 3** commences on the day on which this Act receives the Royal Assent, all other amendments mentioned above take effect from that date.

Amendments to the 175 per cent premium R&D deduction

The R&D tax concessions include an incremental concession at the 175 per cent rate of deduction on any additional expenditure on R&D over the average of their past three year's expenditure under sections 73P to 73Z of the ITAA 1936. Briefly, the additional expenditure is eligible for a further deduction of 50 per cent under subsection 73Y(2) on top of the 125 per cent and is applicable to additional expenditure on R&D made in years of income that commence after 30 June 2001.

Under current tax law, a history of either deductible R&D expenditure or receipts from R&D start grants will meet the three year history requirement under section 73Q of the ITAA 1936.

Replacement of R&D Start Program with the Commercial Ready Program

As the R&D Start Program was abolished and replaced with the Commercial Ready Program commencing on 6 May 2004, **item 10** and **item 15** of **Schedule 3** provide for the three year history requirement for eligibility to the premium R&D deduction to be met by receipts of a subsidy or grant from the Commercial Ready Program.

Distribution of premium incremental concession among a group of companies

There are certain key features of the incremental concession in relation to groups of companies. Relevant to the amendments considered in this paragraph, there are also rules to determine the portion of the premium amount which is distributed to an eligible company. The rules in section 73X are intended to distribute the premium amount between the members of the group that contributed to earning it.

The Explanatory Memorandum states at paragraph 3.12 on page 33, that under current law it is possible that a group of companies will be eligible for an amount of the premium incremental concession without any firm in the group being eligible for the distribution of that amount. To remedy this, **item 19** of **Schedule 3** repeals subsection 73X(1) and inserts **proposed subsection 73X(1)** to provide that the premium amount for an year of income is distributed between each group member that increased its incremental expenditure during its group membership period in that year, based on each company's expenditure over the average of the previous three year's expenditure.

Financial impact

The Explanatory Memorandum to the Bill at page 34 states that this measure is expected to lead to an additional $7 million per year in R&D tax offset payments and decreased revenue of $2.5 million per year as a result of the premium incremental concession.

Application

Items 11 and **16** of **Schedule 3** provide that the amendments made by **items 10** and**15** take effect from 6 May 2004.

Item 20 of **Schedule 3** provides that the amendment made by **item 19** applies to assessments for the year of income following the year of income in which this Act receives the Royal Assent and later years.

Schedule 4—Donation of listed shares to deductible gift recipients

Background

Income tax law allows taxpayers to claim income tax deductions for certain gifts to the value of $2 or more to deductible gift recipients (DGRs). To be a DGR, an organisation must fall within a category of organisations set out in Division 30 of the ITAA 1997 and be endorsed by the ATO, or be specifically listed under that Division.

In the context of the 2006 Budget, the Minister for Revenue and Assistant Treasurer announced on 9 May 2006 a number of measures to enhance philanthropy.[4] The proposed changes included extending a tax deduction for the donation of small parcels of shares to deductible gift recipients.

Main provisions

Taxpayers can claim a deduction for a gift of shares listed on the Australian Stock Exchange shares with a market value not exceeding $5,000

Items 1 to **6** of **Schedule 4** amend subsection 30-15(2) of the ITAA 1997 to allow the deduction of the market value of listed company shares that satisfied the following conditions.

- The market value on the day the shares were gifted should be $5 000 or less.
- The shares were acquired at least 12 months before making the gift.
- The shares are listed for quotation on the official list of an Australian stock exchange.

Share as defined in subsection 995-1(1) applies for this purposes means a share in the capital of the company, and includes stock. Thus securities that are not shares and the derivatives of shares are not covered by this measure.

The Explanatory Memorandum to the Bill adds at paragraph 4.9 on page 38, that shares acquired include those that come into the donor's possession through a variety of means including shares that have been purchased, inherited, won, received as a gift or received as a bonus.

Financial impact

The Explanatory Memorandum to the Bill on page 4 states that this measure will have the following revenue implications:

2007-08	**2008-09**	**2009-10**	**2010-11**
	-$10m	-$11m	-$11m

Application

Item 10 of **Schedule 4** provides that the amendments made by this Schedule apply to gifts and contributions made in an income year commencing on or after the day on which this Act receives the Royal Assent.

Schedule 5—Specifically listed deductible gift recipients

Background and Main provisions

New listings of deductible gift recipients

As mentioned above, certain gifts to the value of $2 or more to specifically listed deductible gift recipients in Division 30 of the ITAA 1997 are tax deductible.

On 14 November 2006, the proposal to list the American Australian Association Limited was announced in the Prime Minister's Media Release.[5]

On 22 December 2006, the proposal to list the Banbury Diocese Cathedral Rebuilding Fund was announced in the Press Release of the Minister for Revenue and Assistant Treasurer.[6]

Items 3 to **6** of **Schedule 5** amend Division 30 of the ITAA 1997 to give effect to these proposals.

In the case of the American Australian Association Limited the amendment by **item 3** requires that the gift must be made after 13 November 2006.

In the case of the Banbury Diocese Cathedral Rebuilding Fund the amendment by **item 4** requires that the gift must be made after 18 December 2006 and before 19 December 2008.

The reader is referred to the background to the listing of these two organisations given in paragraphs 5.7 and 5.8 respectively on page 44 of the Explanatory Memorandum.

Extending period for making gifts to a listed fund

On 10 November 2006, the Minister for Revenue and Assistant Treasurer announced that an extension will be granted to the listing of The Finding Sydney Foundation.[7]

Item 1 of **Schedule 5** amends item 5.2.25 in the table in subsection 30-50(2) by extending from 27 August 2006 to 28 August 2008 when gifts may be made to The Finding Sydney Foundation. It is necessary to restore item 5.2.25 to the table in subsection 30-50(2) by an amendment to *Tax Laws Amendment (Repeal of Inoperative Provisions) Act 2006* effected by the amendment proposed by **item 9** of **Schedule 8**.

Effecting a name change of a listed organisation

Items 2, 7, and **8** of **Schedule 5** propose amendments to subsections 30-65 and 30-315(2) to substitute the former name of the Voluntary Service to Indigenous Communities Foundation under which it was listed, with its present name, namely, Indigenous Community Volunteers Limited.

Financial impact

The Explanatory Memorandum to the Bill at page 5 states that the above measures will have the following revenue implications:

2007-08	**2008-09**	**2009-10**	**2010-11**	**2011-12**
-$5m	-$1m	-$0.7m	-$0.6m	-$0.6m

Application

The amendments made by Schedule 5 commence from the day on which this Act receives the Royal Assent, as provided in item 2 of the table in **subclause 2(1)** of the Bill. However, the individual measures operate as indicated above.

Schedule 6—Deductions for contributions relating to fund-raising events

Background and Main provisions

From 1 July 2004, tax law permitted contributions to fund-raising events of deductible gift recipients (DGRs) to be tax deductible even though the contributor received minor benefits, subject to certain conditions in item 8 of the table in subsection 30-15(2) of the ITAA 1997.

Broadly, to be tax deductible the contribution must be money over $250, or property purchased during the 12 months before making the contribution and valued at more than $250, or property valued by the Commissioner at more than $5,000

The benefit received by the contributor must be no more than 10% of the value of the contribution or $100, whichever is less.

The Australian Taxation Office (ATO) describes fund-raising events of DGRs as follows.[8]

> They include:
>
> - fetes, balls, gala shows, dinners, performances or similar events
>
> - events comprising sales of goods if selling such goods is not a normal part of the supplier's business, and
>
> - events that have been approved by the Commissioner of Taxation as a fundraising event.
>
> To be eligible for the concession, the same type of event cannot be conducted more than 15 times in a financial year.

On 1 December 2006, the Minister for Revenue and Assistant Treasurer and the Minister for Families, Community Services and Indigenous Affairs announced in a Joint Press Release that the minimum contribution threshold will be reduced from $250 to $150 to allow a greater number of charities to use the measure for fund-raising.[9]

In addition, the value of the minor benefit allowed will be increased to 20 per cent of the gift or ticket price but not exceeding a value of $150 (previously 10% not exceeding $100).

The Joint Press Release indicated that the changes will apply from 1 January 2007.

Items 1 to **9** of **Schedule 6** amend the table in subsection 30-15(2) to implement these changes.

Application

Item 10 of **Schedule 6** provides that the amendments made by this Schedule apply and are taken to have applied to contributions made on or after 1 January 2007.

Schedule 7—Technical corrections

Background

The Explanatory Memorandum to the Bill at page 6 states that Schedule 7 addresses:

- a defect in the definition of 'exempt entity' in the ITAA 1997, and
- 'excepted trust' in the ITAA 1936.

It adds that it corrects some minor technical errors in Division 58 of the ITAA 1997 dealing with capital allowances for depreciating assets.

Main provisions

Exempt entities

Item 14 of **Schedule 7** repeals the definition of exempt entity in subsection 995-1(1) of the ITAA 1997 and replaces it with a new definition which has two paragraphs (a) and (b). An entity satisfying any one of these two paragraphs is an exempt entity.

Paragraph (a) provides that an exempt entity means an entity whose ordinary income or statutory income is exempt because of the ITAA 1997 or because of another Commonwealth law regardless of the kind of ordinary income or statutory income it might have.

Paragraph (b) provides that an exempt entity is an untaxable Commonwealth entity.

The reader is referred to paragraphs 7.6 and 7.7 on page 52 as well as paragraphs 7, 9 to 7.12 on page 53 of the Explanatory Memorandum for examples of the problems that have arisen because of the present definition and the results flowing from this amendment, respectively.

Excepted trust

Item 1 of **Schedule 7** amends paragraph 272-100(d) in Schedule 2F of the ITAA 1936 to amend the definition of excepted trust to require all the interests in the income and capital of the trust to be held by exempt entities.

The effect of the changes to the definition of exempt entity and excepted trust is that state and territory bodies exempted by Division 1AB of Part 111 of the ITAA 1936 are treated in the same manner with entities exempted by Division 50 of the ITAA 1997.

Financial impact

The Explanatory Memorandum at page 6 states that the financial impact of the technical amendments and corrections is nil.

Application

The amendment made by **item 14** to the definition of exempt entity applies from 1 July 2005, as provided in item 4 of the table in **subclause 2(1)** of the Bill.

The amendment made by **item 1** to the definition of excepted trust applies from the day on which this Act receives the Royal Assent, as provided in item 3 of the table in **subclause 2(1)** of the Bill.

Schedule 8—Venture capital

Background

Introduction and brief outline of the venture capital tax concessions

The *Venture Capital Act 2002* and the *Taxation Laws Amendment (Venture Capital) Act 2002* introduced tax concessions to facilitate non-resident investment in the Australian venture capital industry. The Pooled Development Funds Board established under the *Venture Capital Act 2002* and the Australian Taxation Office (ATO) jointly administer the tax concessions. The ATO website gives an overview of the operation of the venture capital tax concession and an extract from it is set out below:[10]

> The aim of the concession is to facilitate non-resident investment in the Australian venture capital industry by providing incentives for increased investment to support patient equity capital investments in relatively high-risk start-up and expanding businesses that would otherwise have difficulty in attracting investment through normal commercial terms.
>
> This is achieved by providing tax concessions in certain circumstances to:
>
> - tax-exempt foreign residents' from Canada, France, Germany, Japan, United Kingdom and the United States of America
>
> - foreign venture capital fund of funds' managed and controlled in the countries named above, and

- taxable foreign residents from the countries named above – or from Italy, the Netherlands (excluding the Netherlands Antilles), New Zealand, Norway, Sweden or Taiwan, whose 'committed capital' in the venture capital limited partnership (VCLP) or Australian fund of funds (AFOF) is less than 10%.

Specifically, the concessions provide for:

- flow-through tax treatment to two newly created venture capital investment vehicles – the VCLP and the AFOF where an investment was made either directly or through a VCLP, and

- an exemption from income tax on profits (capital or revenue) from the disposal of eligible Australian investments by partners or members of these investment vehicles, or by 'eligible venture capital investors' who invest directly in such eligible Australian investments.

Review of the Venture Capital Industry

On 20 May 2005, the Minister for Industry, Tourism and Resources, the Hon Ian McFarlane announced [11]the release of the following terms of reference of the Review of the Venture Capital Industry by an expert group headed by Mr Brian Watson:[12]

> 1. Assess the level and sources of venture capital and later stage private equity investment, including historical trends and growth prospects. The Review should identify factors that might impact on levels of Australian venture capital and later stage private equity investment including, but not limited to, the availability of suitable investment opportunities, the accessibility and liquidity of Australian equity markets and proximity to global capital and product markets.
>
> 2. Determine whether there are any impediments to the efficient operation of the venture capital and later stage private equity market and, on this basis, determine whether government intervention is warranted.
>
> 3. Consider the appropriateness, effectiveness and efficiency of existing Australian Government support for venture capital and later stage private equity investment, in the context of a thorough review of the industry, including:
>
> • The Pooled Development Funds program – paying regard to the issues and recommendations raised in the PDF Registration Board's report "Financing Australian SMEs".
>
> • The Venture Capital Regime including venture capital limited partnerships.
>
> • Other programs including Innovation Investment Funds, COMET and the Pre-seed Funds.

> Where feasible, the Venture Capital Review Expert Group may wish to identify features of government intervention by other countries to determine their effectiveness, usefulness and relevance to Australia.
>
> 4. Determine the impact of venture capital (and later stage private equity) activity on the Australian economy.

The Department of Industry, Tourism and Resources website gives the following details of the Innovation Investment Fund Program.[13]

> The objectives of Innovation Investment Fund (IIF) are to:
>
> -encourage the development of new-technology companies commercialising R&D, by addressing capital and management constraints;
>
> -develop a self-sustaining, early-stage, technology-based venture capital industry;
>
> -develop fund managers with experience in the early stage venture capital industry; and
>
> -establish in the medium term a 'revolving' or self-funding program.
>
> Program history
>
> The IIF program was announced in the Small Business Statement of March 1997, and round one licensed funds became operational in 1998. A further round was announced in 2000 with licensed funds' commencing operations in 2001.
>
> The Australian Government, in partnership with the private sector, established nine venture capital funds to invest in small technology based companies, commercialising Australian R&D. By demonstrating the returns achievable from investing in such companies, IIF aims to encourage additional private sector investment.

The report of the review of the venture capital industry was not published, but the changes announced in connection with the 2006 Budget referred to in the following paragraph, would appear to be a response to that report.

Venture capital measures announced in connection with the 2006 Budget

Key features of the venture capital measures announced in a Joint Press Release by the Treasurer and the Minister for Industry, Tourism and Resources in connection with the 2006 Budget were as follows.[14]

- The requirements to qualify for the tax concessions by venture capital limited partnerships (VCLPs) will be relaxed to remove a range of restrictions including allowing investment in unit trusts and convertible notes as well as shares; relaxing the requirement that 50 per cent of assets and employees must be in Australia for 12 months after making the investment; and removing restrictions on the country of residence of investors.

- A new vehicle for venture capital investments will be provided with the establishment of the early stage venture capital limited partnerships (ESVCLPs) with flow through tax treatment and a complete tax exemption for income, both revenue and capital, received by its domestic and foreign partners. To qualify, the ESVCLP must have a maximum fund size of $100 million and total assets of investee companies cannot exceed $50 million immediately prior to investment. The ESVCLP must also divest itself of any holdings once the total assets of the investee company exceed $250 million.
- The progressive replacement of the existing pooled development fund (PDF) programme with ESVCLP. The PDF programme will be closed to new registrations after 31 December 2006.
- The Government will commit $200 million for a further round of funding of the Innovation Investment Fund (IIF) programme to be drawn down over the period 2007-08 to 2018-19. The Government funding will be matched dollar for dollar by private sector funds.

In a separate Press Release issued by the Treasurer on 9 May 2006, the benefits of proposed measures were indicated as follows.[15]

> Who will benefit?
>
> – The new venture capital measures will benefit small to medium enterprises seeking capital injections to finance expansion and start up companies by making it easier for them to obtain capital.
>
> – Venture capital investors will also benefit from this measure. Major beneficiaries from the introduction of the early stage venture capital limited partnership (ESVCLP) vehicle will be domestic resident investors and fund managers as non-resident investors are already expected to benefit from an exemption from capital gains tax as a result of changes announced in the 2005-06 Budget.

Venture capital 2006 Budget measures welcomed by AVCAL

The Australian Private Equity & Venture Capital Association Limited (AVCAL) welcomed the venture capital measures announced with the 2006 Budget, with some reservations.

> We congratulate the Federal Government on their Venture Capital initiatives outlined in the budget. The reforms should add to the supply of venture capital, drive commercialisation of research, develop advanced skills, and contribute to the creation of a knowledge based economy.

Main provisions

Subdivision 118-F of the ITAA 1997 titled 'Venture capital investment', deals with the requirements that must be met for some foreign residents to be entitled to the tax concessions for venture capital investments in Australian companies and in some cases foreign holding companies. These foreign residents can disregard capital gains and capital losses from capital gains tax (CGT) events that relate to these investments.

The eligibility requirements include that these investments are made:

- through limited partnerships, known as venture capital limited partnerships(VCLPs) that are unconditionally registered under Part 2 of the *Venture Capital Act 2002;* or
- through limited partnerships, known as Australian venture capital funds of funds (AFOFs) that are unconditionally registered under Part 2 of the *Venture Capital Act 2002;* or
- directly by foreign residents who are registered under Part 3 of the *Venture Capital Act 2002*.

The significant amendments proposed in each of the three Parts of **Schedule 8** will be considered in this section of this Bills Digest.

Part 1—Venture capital limited partnerships—Relaxing eligibility requirements

As mentioned above, the joint press release issued on 9 May 2006 by the Treasurer and the Minister for Industry, Tourism and Resources indicated that the eligibility requirements for qualifying to be treated under the venture capital regime will be relaxed.

The significant measures proposed in **Schedule 8** are considered below.

Broaden the meaning of eligible venture capital investments to include convertible notes in a company and units in unit trusts

Section 118-425 sets out the requirements for an eligible venture capital investment (VCI). It requires that the investments be either in shares or options in a company in paragraph 118-425(1)(b).

Items 26, **27**, **28** and **29** of **Schedule 8** amend paragraph 118-425(1)(b) to include investments in convertible notes that are equity interests in a company, other than convertible notes that are debt interests, as an eligible venture capital investment.

Item 44 of **Schedule 8** inserts **proposed section 118-427** to allow acquisition of units in unit trusts to be eligible venture capital investments.

The reader is referred to paragraphs 8.11 to 8.18 on pages 63 to 67 of the Explanatory Memorandum for details of the requirements to be met by the convertible notes and units in unit trusts to be eligible venture capital investments.

Relaxation of the requirement that investee entities must be located within Australia

Currently, subsection 118-425(2) of the ITAA 1997 requires that the company must at the time the investment is made be an Australian resident. In addition if it is the entity's first investment in the company, the company must have more than 50 per cent of its employees and assets located in Australia for 12 months after the investment is made. The Pooled Development Fund Board may determiner a shorter period than 12 months under section 25-5 of the *Venture Capital Act 2002*.

Item 30 adds a Note at the end of subsection 118-425(2) to indicate that a company that fails to meet the requirements of this subsection in relation to location in Australia can still be eligible in certain circumstances and directs attention to **proposed subsection 118-425(12A)**.

Item 43 of **Schedule 8** inserts **proposed subsection 118-425(12A)** to provide that a company is taken to meet the requirements in subsection 118-425(2) in relation to location in Australia where the sum of the value of the investments at the time the entity makes it and the value of all other investments owned by the entity does not exceed 20 per cent of the partnership's committed capital.

Changes to residency requirements of investors

Amendments made by Schedule 4 of the *Tax Laws Amendment (2006 Measures No. 4) 2006* to the CGT provisions of the ITAA 1997 limit the scope of CGT assets to taxable Australian property for foreign residents. The amendments apply to CGT events occurring on or after 12 December 2006 - the date of Royal Assent. [16]

To bring the venture capital provisions in line with these recent CGT changes the country of residence restrictions in section 118-420 are being relaxed.

The amendments proposed to section 118-420 by **items 19** to **25** of **Schedule 8** to the ITAA 1997 allow limited partners of VCLPs to be resident of any foreign country.

The amendments proposed by **item 54** of **Schedule 8** to the *Venture Capital Act 2002* repeals paragraph 9-1(1)(a) and substitutes **proposed paragraph 9-1(1)(a)** to relax the residency requirements for general partners and VCLPs. These amendments allow VCLPs and general partners to be resident in, or established in, any country with which Australia has a double tax agreement in force as defined in Part X of the ITAA 1936.

Part 2—Providing tax concessions for Australian residents and foreign residents investing in early stage venture capital activities limited partnerships

Amendments are proposed to the *Venture Capital Act 2002*, the *Pooled Development Funds Act 2002* and the ITAA 1997 to provide for a new limited partnership investment vehicle to be called an early stage venture capital limited partnership (ESVCLP).The following significant amendments to these Acts are considered in this section of the Bills Digest.

Significant amendments to the *Venture Capital Act 2002*

Item 171 of **Part 2** of **Schedule 8** inserts **proposed section 9-3** to the *Venture Capital Act 2002* to set out the registration requirements of ESVCLPs. The registration requirements in **proposed subsection 9-3(1)** are targeted at early stage activities of projects. Registration under the *Venture Capital Act 2002* is a condition for being eligible for the tax concessions under the ITAA 1997.

Registration requirements

The significant registration requirements are as follows.

- The ESCVLP was established by or under a law in force in Australia or established in, any country with which Australia has a double tax agreement in force as defined in Part X of the ITAA 1936 (proposed paragraph 9-3(1)(a)).
- All the partners who are general partners are either resident in Australia or in a country with which Australia has a double tax agreement in force as defined in Part X of the ITAA 1936 (proposed paragraph 9-3(1)(b)).
- The partnership agreement should provide for the partnership to remain in existence for a period of not less than 5 years and not more than 15 years with which Australia has a double tax agreement in force as defined in Part X of the ITAA 1936 (proposed paragraph 9-3(1)(c)).
- The committed capital of the ESVCLP must be at least $10 million and cannot exceed $100 million (proposed paragraph 9-3(1)(d)).
- An investment by any partner and his associates cannot exceed 30 per cent of the ESVCLPs committed capital (proposed paragraph 9-3(1)(e)).
- The ESVCLP must not continue to hold investments in an entity if at the end of the ESVCLP's preceding income year , the sum of the values of the assets of the company or unit trust and the assets of each other entity that is a connected entity exceed $250 million (proposed paragraph 9-3(1)(e) and proposed subsection 9-3(6)).
- The ESVCLP must have an investment plan approved by the Venture Capital Registration (VCR) Board (proposed sections 13-15 and 13-20).

- The ESVCLP must submit annual reports to the VCR Board on the implementation of the approved investment plan. The VCR Board must publish such reports (proposed section 15-17).

Significant amendment to the ITAA 1997 to provide for tax concessions to ESVCLPs

The main amendments in relation to the tax concessions provided in the Bill are briefly considered below.

Flow-through treatment

Division 5A of Part 111 of the *Income Tax Assessment Act 1936* (ITAA 1936) taxes certain limited partnerships as companies. However, subsection 94D(2) in Division 5A provides that a partnership that is a VCLP, an AFOF or a venture capital management partnership (VCMP) cannot be a corporate limited partnership. The amendments proposed by **items 89** to **92** of **Schedule 8** to subsection 94D(2) are for the purpose of excluding ESVCLPs from the application of Division 5A and hence ESVCLPs will not be treated as companies for tax purposes. In consequence, ESVCLPs will be taxed under Division 5 of Part 111 of the ITAA 1936 as flow through vehicles.

Division 5 provides that each partner of any partnership is assessable on its share of the net income and is allowed a deduction for its share of any partnership loss. As limited partners are only liable for the debts of the limited partnership to the extent of their investment in the partnership section 92(2AA) provides for the losses allowed to limited partners to be limited to the extent of their outstanding financial commitment to the partnership. **Item 88** of **Schedule 8** proposes amendments to section 92(2AA) and 92A to extend these provisions which limit the losses allowed to limited partners of VCLPs, AFOFs or Vamps to limited partners of ESVCLPs.

Income tax exemption of income derived from eligible venture capital investments by ESVCLPs

Item 105 of **Schedule 8** inserts **proposed section 51-52** to the ITAA 1997 to exempt income from eligible venture capital investments by ESVCLPs. The reader is referred to paragraphs 8.48 and 8.49 of the Explanatory Memorandum for details of the conditions to be met to qualify for this exemption.

Items 106 to **109** amends section 51-54 of the ITAA 1997 to exempt partners of ESVCLPs from income tax on any gains or profits from the disposal of eligible venture capital investments. This exemption is now available to partners in VCLPs and AFOFs under section 51-54.

Exemption from tax from capital gains

Item 119 of **Part 2** of **Schedule 8** inserts **proposed section 118-407** into Subdivision 118-F of the ITAA 1997 to provide exemption of capital gains from tax for certain venture capital investments made through early stage venture capital limited partnerships (ESVCLPs).

Proposed subsection 118-407(1) provides that the share of a capital gain or capital loss from a CGT event is disregarded if certain conditions are satisfied.

Part 3—The Venture Capital Registration Board

Changing of the name of the PDF Registration Board to the Venture Capital Registration Board

Item 217 of **Schedule 8** repeals section 5 of the *Pooled Development Funds Act 1992*. It substitutes **proposed section 5** to effectively change the name of the PDF Registration Board to the Venture Capital Registration Board. This takes effect from the date of commencement of the proposed section.

Part 3 of Schedule makes consequential amendments to the ITAA 1997 and the *Venture Capital Act 2002* to reflect the change in name of the PDF Registration Board to the Venture Capital Registration Board.

Part 4—Pooled development funds

Closure of the PDF regime

Item 349 of **Schedule 8** inserts **proposed subsection 11(4A)** to the *Pooled Development Funds Act 2002* to provide that new applications must not be made after the day Part 4 of Schedule 8 to the *Tax Laws Amendment (2007 Measures No.2) Act* commences. Thus the PDF regime is closed to new applications after the commencement of this Act.

Part 5—Conditional registration

The Explanatory Memorandum to the Bill states at paragraph 8.84 on page 83 that the amendments proposed by **items 350** to **353** of **Schedule 8** are technical amendments to ensure that eligible partners in conditionally registered VCLPs and AFOFs are entitled to the tax exemption on the profits and gains derived by the partnership while the partnership was conditionally registered.

ESVCLPs will receive similar treatment under amendments proposed in **items 180** to **183** of **Part 2** of **Schedule 8.**

Financial impact

The Explanatory Memorandum at page 7 states that the venture capital measures will have the following revenue implications.

2007-08	2008-09	2009-10	2010-11
	-$2m	-$7m	-$16m

Application

Clause 2 of the Bill provides a table of commencement information. **Item 6** provides that the commencement date for Parts 1 to 4 of Schedule 8 is the day of which this Act receives the Royal Assent.

Item 85 of **Schedule 8** provides that the amendments made by **Part 1** of **Schedule 8** apply to assessments for the 2007-2008 year of income and later years of income. The amendments in Part 1 of Schedule relate to relaxing the eligibility requirements for venture capital limited partnerships.

Item 205 of **Schedule 8** provides that the amendments to the ITAA 1997 made by **Part 2** of **Schedule 8** apply to assessments for the 2007-08 year of income and later years. These amendments related to providing the tax incentives for investment in early stage venture capital through the ESVCLP vehicle.

Item 7 in the table in **clause 2** of the Bill provides that the amendments made by **Part 5** of **Schedule 8** will commence immediately after the commencement of the *Venture Capital Act 2002*. Column 3 of the table provides the information that the relevant date is 19 December 2002.

Concluding comments

Venture capital measures – Are there restrictions on private equity activities?

This Bill implements the venture capital measures announced in the 2006 Budget following a Review of the Venture Capital Industry (the Review) undertaken in 2005. The Australian Venture Capital Association (AVCAL) had prior to the Review warned that serious shortages would occur as start-up companies and entrepreneurs found themselves competing for funds with Baby Boomer business owners looking to sell their businesses and retire.[17]

AVCAL has welcomed the 2006 Budget initiatives but had expressed reservations about some of the restrictions which will inhibit private equity activities.

> Unfortunately, the government does not yet get the message that private equity drives productivity growth in services and manufacturing, drives economic modernization and reform and delivers higher returns to super funds, including bureaucrats and politicians! [18]

Allens Arthur Robinson (AAR) in an article in their website assessing the impact of the 2006 Budget venture capital measures made the following comments on the restrictions that have been imposed on early stage venture capital limited partnerships (ESVCLPs).

> ESVCLPs will be tax flow-through vehicles (like VCLPs) however income and capital gains earned by ESVCLPs will be exempt from any Australian tax. This exemption will apply to both residents and non-residents.
>
> This is a significant concession, both in comparison to VCLPs and PDFs. However, the attractiveness of these concessions must be measured against the following restrictions that will apply to ESVCLPs:
>
> – the maximum size of the fund administered by an ESVCLP is $100 million;
>
> – ESVCLPs will not be able to invest in investee entities having total assets exceeding $50 million (this restriction already applies to PDFs);
>
> – once the total assets of an entity invested in by an ESVCLP exceeds $250 million, the ESVCLP must divest itself of that entity (a significant and onerous requirement that may prove to make ESVCLPs unattractive vehicles for private equity, despite the tax concessions); and
>
> – losses from ESVCLPs will not be deductible by the partners (the justification given by the Government being that, as revenue and capital gains are not taxable, losses should not be deductible).[19]

The AAR article refers to AVCAL's disappointment that "target investees must have less than $250 million in assets (a restriction generally not imposed in other jurisdictions". However, the AAR article ends on a positive note that the Budget measures take Australia towards a more competitive regime for attracting venture capital.

> The negative reception is not surprising given that two of AVCAL's key suggestions for VCLP reform – removing the $250 million cap and ending the prohibition on investment in financial services – have been ignored. Nevertheless, with these initiatives the Government has moved somewhat closer to establishing an internationally competitive regime for encouraging venture capital investment in Australia.

It appears that a close monitoring of the progress made in attracting venture capital to Australia will be required to ensure that the demands of the venture capital industry are met adequately.

Endnotes

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5. The Hon John Howard, MP, the Prime Minister and the Hon Peter Costello, MP, the Treasurer, United States Study Centre, Media Release, Parliament House, Canberra, 14 November 2006.
6. The Hon Peter Dutton, MP, the Minister for Revenue and Assistant Treasurer, Deductibility of Gifts to Bunbury Diocese Cathedral Rebuilding Fund (The Bunbury Fund)Parliament House, Canberra, 22 December 2006.
7. The Hon Peter Dutton, MP, the Minister for Revenue and Assistant Treasurer, Deductibility of Gifts to the Finding Sydney Foundation, Parliament House, Canberra, 10 November 2006.
8. ATO Fact sheet titled Tax deductible contributions - Non-profit organisations and fundraising at http://www.ato.gov.au/nonprofit/content.asp?doc=/content/56543.htm&page=2&H2 on 2 May 2007.
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10. ATO fact sheet titled 2002 venture capital tax concession: overview at http://www.ato.gov.au/large/content.asp?doc=/content/70986.htm on 2 May 2007.
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12. Review of the Venture Capital Industry, Terms of Reference.
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14. The Hon Peter Costello, MP, Treasurer and the Hon Ian McFarlane, MP, the Minister for Industry, Tourism and Resources, *Further Boost to Australia's Venture Capital Sector*, Joint Press Release, Joint Press Release, Parliament House, Canberra ,9 May 2006.

15. The Hon Peter Costello, MP, Treasurer, *Further Boost to Australia's Venture Capital Sector*, Press Release, Parliament House, Canberra, 9 May 2006.

16. For an explanation of what is taxable Australian property in relation to foreign residents please click here for a link to the ATO fact sheet titled *Capital Gains and foreign residents* (30 January 2007).

17. Rebecca Martin, *Venture capital urges shake-up,* ABC Online 27 May 2005.

18. IN-form, the AVCAL News Letter, *Federal Budget Impact on VC & PE*, 10 May 2006.

19. AAR Publication: Focus, Private Equity – May 2006

Members, Senators and Parliamentary staff can obtain further information from the Parliamentary Library on (02) 6277 2469.