The Senate

Economics Legislation Committee

Treasury Laws Amendment (2018 Measures No. 2) Bill 2018 [Provisions]

March 2018

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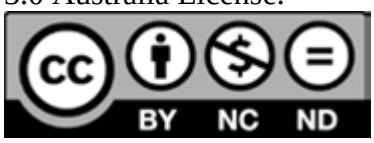

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Chapter 1

Introduction

1.1 On 15 February 2018, the Senate referred the provisions of the Treasury Laws Amendment (2018 Measures No. 2) Bill 2018 (the bill) to the Senate Economics Legislation Committee for inquiry and report by 15 March 2018.[1]

1.2 The bill establishes an enhanced 'regulatory sandbox' to allow firms to test new products and services in the financial services sector without needing to obtain a financial services licence or a credit licence from the Australian Securities and Investments Commission (ASIC) first. The bill also makes a number of minor technical amendments to the Early Stage Venture Capital Limited Partnership, Venture Capital Limited Partnership and Tax Incentives for Early Stage Investor regimes to clarify the income tax law and ensure these provisions operate in accordance with their original policy intent.[2]

1.3 The Treasurer, the Hon. Scott Morrison MP, summarised the benefits of creating an enhanced regulatory sandbox for new and innovative financial technologies (FinTech):

> As promised in the Budget, we are putting in place the world's most forward-leaning regulatory sandbox for FinTech development.
>
> …
>
> In simple terms, this will help Australians and Australian businesses to access cheaper financing and better financial products so they can grow and invest.
>
> …
>
> The regulatory sandbox will provide a means to test market demand…It will reduce the time it takes to make their products and services available to consumers and it will mean entrepreneurs are more informed in making decisions on their offering before applying for a licence.[3]

1.4 In relation to the venture capital and early stage investor tax concessions, the Treasurer concluded that:

> The amendments made by this Bill will ensure that investors in innovative Australian businesses continue to benefit from effective, generous

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1 *Journals of the Senate*, No. 87, 15 February 2018, p. 2739.

2 The Hon. Scott Morrison MP, Treasurer, *House of Representatives Hansard*, 8 February 2018, pp. 4–5.

3 The Hon. Scott Morrison MP, Treasurer, *House of Representatives Hansard*, 8 February 2018, p. 4.

Government support and have certainty as to how these programmes are intended to operate.[4]

Conduct of the inquiry

1.5 The committee advertised the inquiry on its website. It also wrote to relevant stakeholders and interested parties inviting written submissions by 28 February 2018. The committee received 3 submissions, which are listed at Appendix 1.

1.6 The committee held a public hearing for the inquiry in Melbourne on 6 March 2018. The witnesses who attended the public hearing are listed at Appendix 2.

1.7 The committee thanks all individuals and organisations that took the time to make a written submission.

Overview of the bill

1.8 The bill makes amendments to a variety of acts and contains two schedules:

- Schedule 1 amends the *Corporations Act 2001* (Corporations Act) and the *National Consumer Credit Protection Act 2009* (Credit Act) to expand the regulation-making powers to allow the regulations to provide for exemptions from the Australian Financial Services Licence (AFSL) and Australian Credit Licence (ACL) requirements for the purposes of testing financial and credit products and services under certain conditions.
- Schedule 2 amends the *Income Tax Assessment Act 1997* (ITAA 1997) venture capital and early stage investor tax concession provisions to make minor changes to ensure that the provisions operate as intended.[5]

FinTech Sandbox Regulatory Licensing Exceptions

1.9 Since December 2016, ASIC has provided a regulatory sandbox framework to allow new and innovative FinTech products and services to be tested in Australia without obtaining a licence from ASIC. The enhanced regulatory sandbox proposed in the bill would allow more businesses to test a wider range of new financial and credit products and services without a licence from ASIC, for a longer time.[6]

1.10 The enhanced regulatory sandbox is intended to:

- further promote Australia's FinTech capability by supporting start-ups and innovative businesses to develop, test and launch financial and credit products and services under certain conditions; and

4 The Hon. Scott Morrison MP, Treasurer, *House of Representatives Hansard*, 8 February 2018, p. 5.

5 Explanatory Memorandum, p. 3.

6 Explanatory Memorandum, p. 5.

- strike a better balance in encouraging innovation that delivers choice for consumers and minimising risks to consumers and the integrity of the financial system.[7]

1.11 Part 1 of Schedule 1 of the bill would extend the regulation-making power in section 926B of the Corporations Act to allow regulation to provide conditional exemptions from the AFSL requirements for the purpose of testing certain financial products and services.

1.12 Part 2 of Schedule 1 of the bill extends the regulation power in section 110 of the Credit Act to enable regulations to provide conditional exemptions from the ACL requirements for the purpose of testing certain credit services or the issuance of certain credit contracts.[8]

1.13 In relation to the proposed amendments to both the Corporations Act and the Credit Act, the Explanatory Memorandum argues that it is appropriate for the conditional exemption from the AFSL and ACL requirements to be in the regulations so that the Government can make timely changes in response to the changing market. As the market changes and develops, it is important to have the flexibility to make changes to the types of eligible products and services to ensure the exemption operates appropriately. It may also be necessary to adjust the conditions under which they can be tested to maintain an appropriate balance between facilitating innovation and providing investor protections.[9]

1.14 Further, the adaptive nature of the proposed regulatory sandbox will provide consumer protections and Parliamentary oversight:

> Extending the regulation making powers and prescribing the conditions in the regulations will let the regulatory sandbox evolve with the market to ensure that it stays fit for purpose, allowing for the innovation and growth of the FinTech sector over time, while providing consumer protections for investors. This flexible approach sets Australia's regulatory sandbox apart from its international equivalents. As the regulations are subject to disallowance, there will be appropriate Parliamentary scrutiny of the eligible products and services and conditions for businesses testing in the regulatory sandbox.[10]

1.15 ASIC would be empowered to make decisions regarding how the exemption starts and ceases to apply to a person or class of persons. This provision is necessary to allow ASIC to minimise risks and protect consumers where unintended and undesirable behaviour from firms is identified. For example, if a provider is not compliant with any of the conditions set out in the regulations, ASIC can stop the provider from relying on the exemption or seek an order from the court that a

7 Explanatory Memorandum, p. 5.

8 Explanatory Memorandum, p. 8.

9 Explanatory Memorandum, pp. 7–9.

10 Explanatory Memorandum, pp. 7 & 9.

condition should be complied with in a particular way. In appropriate circumstances, ASIC could also prevent a provider from starting to use the exemption.[11]

1.16 By allowing ASIC to make decisions about how the exemption starts and ceases to apply, ASIC would have the flexibility to provide arrangements to transition providers effectively from the exemption to becoming licensed.[12]

1.17 In relation to Part 1, any decisions made by ASIC are subject to review by the Administrative Appeals Tribunal (AAT) under section 1317B of the Corporations Act. In relation to Part 2, decisions made by ASIC under paragraph 327(1)(i) of the Credit Act are only subject to AAT review if the regulations specifically provide for this. The Explanatory Memorandum clarifies how the review mechanism is intended to operate:

> …to ensure consistency across the application of the Corporations and Credit Acts to the regulatory sandbox, the Government intents [sic] that the regulations would specifically provide for AAT review for ASIC decisions relation to exemptions for ACL requirements.[13]

Innovation measures

Background

1.18 Venture capital is a mechanism for financing new, innovative enterprises at the seed, start-up and early-expansion stages of commercialisation. The Commonwealth provides various tax concessions to support Australian venture capital investments; specifically the venture capital limited partnership (VCLP) and early stage venture capital limited partnership (ESVCLP) programs.[14]

1.19 The VCLP regime supports investment in venture capital entities at the start-up and expansion stages that would otherwise have difficulty in attracting investment through normal commercial means.[15]

1.20 VCLPs are taxed on a 'flow-through' basis rather than being treated as a company for tax purposes like other limited partnerships. This results in the partners rather than the 'partnership' being taxed. One of the key benefits is that certain foreign partners are exempt from income tax on capital and revenue gains from disposals of eligible investments made by the VCLP, with corresponding losses also being disregarded. In addition, amounts received by general partners for their successful management of the partnership's investments ('carried interests') are taxed on capital account, thus potentially entitling them to the Capital Gains Tax (CGT) discount if they have been a partner for over 12 months and meet the other eligibility requirements for the CGT discount.[16]

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11 Explanatory Memorandum, p. 8.

12 Explanatory Memorandum, p. 8.

13 Explanatory Memorandum, pp. 8–10.

14 Explanatory Memorandum, p. 13.

15 Explanatory Memorandum, p. 13.

16 Explanatory Memorandum, p. 13.

1.21 The ESVCLP regime provides additional tax concessions for high-risk start-up entities with a value of no more than $50 million. Like VCLPs, ESVCLPs are taxed on a 'flow-through' basis. However, the tax concessions are more generous given the higher degree of risk involved. Both Australian and foreign investors are exempt from income tax on capital and revenue gains from disposals of investments made by ESVCLPs, with corresponding losses also being disregarded. Income derived from the partnership's investments, such as dividends, is also exempt from tax.[17]

1.22 A separate incentive was also introduced for early stage investors outside the venture capital framework. Broadly, this incentive allows eligible investors that acquire shares in an innovation company in an income year to receive a carry forward tax offset for that income year equal to 20 per cent of the amount paid for the shares. However, the total amount of this offset to which an entity and its affiliates is entitled in an income year cannot exceed $200 000.[18]

Capital Gains Tax amendments

1.23 Part 1 of Schedule 2 would make changes to the concessional CGT treatment for investments in ESVCLPs and VCLPs to ensure they operate as intended.

1.24 The proposed amendment to subsection 118-408(2) of the ITAA 1997 clarifies the extent to which tax concessions are available to ESVCLPs disposing of investments made once the $250 million threshold has been exceeded by the investee. Specifically, it makes clear that the capital gain valuation is determined based on what the capital proceeds would have been if the events resulted in the gain happening at the end of the period six months after the end of the relevant valuation year. Other matters relating to the amount of the gain would be determined on a reasonable basis taking into account this premise.[19]

1.25 A further proposed amendment to subsection 118-428 clarifies that ESVCLPs can only acquire a pre-owned investment if the sum of all pre-owned investments following the acquisition does not exceed 20 per cent of the partnership's committed capital.[20]

Early stage investor tax offsets

1.26 Part 2 of Schedule 2 would amend early stage investor tax offset provisions to ensure they operate as originally intended.

1.27 To ensure that where an investor is entitled to the ESVCLP tax offset they do not also qualify for the early stage investor tax offset, an eligibility requirement is to be included in Division 360 of the ITAA 1997. This has the effect that an investor will only qualify for the offset if they are not an ESVCLP.[21]

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17 Explanatory Memorandum, p. 14.

18 Explanatory Memorandum, p. 14.

19 Explanatory Memorandum, p. 15.

20 Explanatory Memorandum, p. 16.

21 Explanatory Memorandum, p. 18.

1.28 In order to qualify for the early stage investor tax offset, an investor must not hold more than 30 per cent of the equity interests in an early stage innovation company or any entities connected with that company. The proposed amendment clarifies what is meant by 30 per cent of the equity interests in the company or entity. This change would ensure that the equity test for early stage investor tax offset applies in a manner that is consistent with its application in other parts of income tax law.[22]

1.29 In relation to widely held companies, an amendment is proposed that would make clear the restriction on tax offsets for widely held companies and their subsidiaries also applies for investments made by these companies indirectly through trusts and partnerships.[23]

1.30 Where investments have been made through a chain of trusts or partnerships, a proposed amendment would clarify that the early stage investor tax offset is available to members of trusts and partnerships as long as they are eligible.[24]

1.31 For the purposes of calculating the amount of early stage investor offset, a proposed amendment sets the offset at 20 per cent of the amount of the sum of any money and non-cash benefits received or entitled to be received by the company in return for the issue to the shareholder of the shares. The value of the non-cash benefits is their value at the time the shares were issued to the shareholder.[25]

1.32 Currently, there is no limit on the amount of early stage investor tax offset that can be claimed for indirect investments. A proposed amendment would ensure that the $200 000 income year limit applies as a single combined limit to both direct and indirect investments. A minor consequential amendment would also be made to the rules setting out the amount of the early stage investor tax offset for trustees to clarify that, for the purpose of this calculation, it is not relevant if members of the trust have reached this cap.[26]

1.33 To ensure that the entitlement to tax offset reflects the entitlement to a fixed proportion of any capital gain, the provisions setting out this requirement would be amended to specify that the relevant disposal is the disposal of the investment that would give rise to, or gave rise to, the entitlement to the early stage investor tax offset. This ensures there is no ambiguity where different entitlements exist in relation to different assets.[27]

22 Explanatory Memorandum, pp. 18–19.

23 Explanatory Memorandum, p. 19.

24 Explanatory Memorandum, p. 19.

25 Explanatory Memorandum, p. 20.

26 Explanatory Memorandum, p. 20.

27 Explanatory Memorandum, p. 21.

1.34 A proposed amendment would modify the requirement to be recently incorporated or registered on the Australian Business Register to provide certainty to the company that the requirement is satisfied.[28]

1.35 A proposed amendment would also ensure that foreign companies, as defined in the Corporations Act, are no longer able to be early stage innovation companies.[29]

1.36 To clarify when an early stage innovation company is doing something, a note is added to explain that, under the general principles of agency, one way a company can demonstrate it is doing something is by engaging the services of another entity.[30]

Managed investment trusts and public trading trusts

1.37 Proposed amendments would permit managed investment trusts (MIT) to invest in an Australian venture capital fund of funds (AFOFs) by including them in the exception that permits them to invest in VCLPs and ESVCLPs.[31]

1.38 To overcome an interaction between the MIT eligibility rules in the ITAA 1997 and the public trading trust provisions in the ITAA 1936, a proposed amendment would amend the definition of a public trading trust to ensure that, in considering if a trust is a public trading trust, investments in ESVCLPs, VCLPs and AFOFs are disregarded if trusts are MITs.[32]

Scrutiny of bill and human rights implications

1.39 The Scrutiny of Bills Committee reviewed the bill in the *Scrutiny Digest 2 of 2018* and identified some concerns regarding the bill.

1.40 That committee was concerned that regulations foreshadowed in Schedule 1 would:

> …confer a broad power on ASIC to determine when particular exemptions apply. The committee is concerned that, while the explanatory memorandum provides some guidance when ASIC's powers would be exercised, this guidance is not reflected on the face of the bill.[33]

1.41 Similarly, that committee was also concerned that decisions made under the regulations would be disallowable instruments:

> The committee is therefore concerned that proposed paragraphs 926B(5) and 110(4) would permit ASIC to make relatively significant decisions relating to the application of exemptions without subjecting those decisions to appropriate levels of parliamentary scrutiny.[34]

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28 Explanatory Memorandum, pp. 21–22.

29 Explanatory Memorandum, p. 22.

30 Explanatory Memorandum, p. 22.

31 Explanatory Memorandum, p. 16.

32 Explanatory Memorandum, pp. 17–18.

33 Standing Committee on the Scrutiny of Bills, *Scrutiny Digest 2 of 2018*, p. 52.

34 Standing Committee on the Scrutiny of Bills, *Scrutiny Digest 2 of 2018*, p. 53.

1.42 In addition, that committee highlighted the retrospective nature of the proposed amendments in Item 18 of Schedule 2:

> The committee notes that the explanatory memorandum does not specify whether any person has been, or may be, adversely affected by the retrospective application…It is unclear whether trusts that complied with the law as written (including the omission) could be adversely affected by the retrospective application of the amendments in the present bill.[35]

1.43 In all three instances, that committee requested that the Treasurer provide more detailed advice.

1.44 The Explanatory Memorandum states that the bill is compatible with human rights as it does not raise any human rights issues.[36]

35 Standing Committee on the Scrutiny of Bills, *Scrutiny Digest 2 of 2018*, p. 54.

36 Explanatory Memorandum, pp. 11 & 23.

Chapter 2

Views on the bill

2.1 While most of the stakeholder feedback centred on the reforms to the FinTech regulatory sandbox (Schedule 1), some views were expressed on the minor amendments to the venture capital tax concessions (Schedule 2).

Views on the enhanced FinTech regulatory sandbox (Schedule 1)

2.2 All the stakeholders who participated in the inquiry were supportive of the general intent of the enhanced regulatory sandbox for FinTech innovation, given that the existing sandbox was seen to be limited. For example, Mr Stuart Stoyan, Chair of FinTech Australia, noted that the existing regulatory sandbox was ineffective in terms of the conditions placed on potential users of the regime:

> Limiting the operation and the oversight that ASIC would have on the sandbox meant that it was very prescriptive, and a number of exclusions were put in place which meant it was just ineffective. Therefore, most fintechs in the fintech community hadn't really contemplated seriously using the sandbox.[1]

2.3 However, Mr Stoyan, when reflecting on the proposed enhanced regulatory sandbox, concluded that:

> We believe the legislation is a step towards providing this new, more flexible environment, and, at the same time, introduces new safeguards to help protect consumers which don't exist in the current sandbox.[2]

2.4 Similarly, the Australian Private Equity and Venture Capital Association Limited (AVCAL) supported:

> …efforts to create a policy environment conducive to the development of a thriving FinTech ecosystem in Australia.
>
> …
>
> Accordingly, AVCAL supports initiatives such as the development of an enhanced regulatory sandbox. Such steps are critical, not only to ensure the financial services industry continues to make a major contribution to our economy, but also that in an increasingly global marketplace for ideas and capital Australia is able to compete effectively.[3]

2.5 Ms Erin Turner, representing CHOICE, provided qualified support for the bill:

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1 Mr Stuart Stoyan, FinTech Australia, *Proof Committee Hansard*, 6 March 2018, p. 5.

2 Mr Stuart Stoyan, FinTech Australia, *Proof Committee Hansard*, 6 March 2018, p. 5.

3 Australian Private Equity and Venture Capital Association Limited, *Submission 3*, pp. 1–2.

> We think the intent of the legislation...is great. It's just about making sure that loopholes can't be used to harm consumers.[4]

2.6 A variety of stakeholders, including consumer groups and FinTech Australia, considered that there should be greater consumer protections in the enhanced regulatory sandbox. CHOICE, the Consumer Action Law Centre (CALC) and the Financial Rights Legal Centre (FRLC) noted that:

> We need to ensure that innovation leads to services that genuinely meet the needs of Australian consumers rather than simply selling a toxic product in a more effective way.[5]

2.7 CHOICE, CALC and FRLC advocated for ASIC to assess whether services are innovative and good for consumers before a regulator exemption is granted:

> Our first preference…would be for ASIC to assess applicants before they're granted a regulatory exemption or entry into the sandbox, similar to the approach used in the UK, Singapore and Hong Kong.[6]

2.8 But this view was not shared universally. AVCAL supported the proposed approach to not require users of the sandbox to seek ASIC approval:

> This is a well-considered approach, rather than requiring firms to proactively seek ASIC approval…It will also be an improvement on the current law which does not specifically provide for *conditional* exemptions from the AFSL or ACL licensing conditions, thereby creating regulatory and legal uncertainty.[7] (emphasis in original)

2.9 Indeed, both Treasury and ASIC discussed the issue of setting objective criteria for 'innovative' and 'consumer benefit'. When questioned about how consumer benefit could be demonstrated, Mr John Price, ASIC Commissioner, commented that:

> These sorts of concepts, while easy to state, may be very difficult to apply in practice. I'd have a similar comment in relation to what's innovative and what's not innovative. There are people who would argue that blockchain technology is not particularly innovative; it is just a distributed nature of a database. The database is like any other but it is distributed on many computers. Again, these are areas where reasonable minds might differ and that's one of the reasons why some of these policy issues are so challenging.[8]

2.10 Mr Price discussed issues surrounding the definition of concepts such as 'consumer detriment':

> Are we talking about hypothetical detriment or actual detriment over a certain period? How is that detriment measured? You can always create

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4 Ms Erin Tuner, CHOICE, *Proof Committee Hansard*, 6 March 2018, p. 2.

5 CHOICE, CALC and FRLC, *Submission 1*, p. 2.

6 CHOICE, CALC and FRLC, *Submission 1*, pp. 3-4.

7 Australian Private Equity and Venture Capital Association Limited, *Submission 3*, p. 2.

8 Mr John Price, ASIC, *Proof Committee Hansard*, 6 March 2018, p. 12.

> rules around those things. But the question is: do those rules lock you into a position that is actually not that helpful or will lead to unintended consequences?[9]

2.11 Similarly, Treasury also considered these issues in relation to coming up with an appropriate definition of 'innovation'. Ms Shellie Davis, Senior Adviser from Treasury, indicated that:

> Those issues are being very actively considered in terms of providing advice to government on the final design arrangements.[10]

2.12 In addition to concerns about consumer protection and innovation, Mr Stoyan noted that FinTech Australia had raised a variety of concerns in relation to the proposed regulations as part of the Treasury consultation process, including:

- transaction limits for most products are too low and would exclude many potential clients from using services offered in the sandbox;
- the retail client limit of 100 will mean that low-value, high-transaction volume products and business models cannot test effectively in the sandbox;
- the $85 000 sum insured limit for retail general insurance is not necessarily workable and should be replaced by a cap based on gross premium; and
- duly authorised product providers would be excluded, thereby limiting the majority of Australian insuretech businesses from entering the market.[11]

2.13 Despite the final regulations not being released with the introduction of the bill, stakeholders indicated their confidence that the regulations would address their concerns. For example, Mr Stoyan concluded that:

> We believe that the new regulations and legislation proposed, with a rider assuming the ongoing discussions we've had with Treasury over the last couple of months have come into effect, will not only encourage greater participation but lead to better outcomes, because you see more FinTechs wanting to innovate in the sandbox. We're a strong proponent of the belief that it's much better to do this in the sandbox than outside the sandbox, because that potentially leaves the opportunity for businesses to conduct themselves in an entirely unregulated way.[12]

2.14 That said, AVCAL warned that the regulatory conditions will be central to how many firms potentially use the enhanced sandbox:

> …the success of the proposed regulatory sandbox will depend on the relevant conditions being legally and commercially viable for market participants. If the conditions are too onerous, the sandbox is unlikely to be

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9 Mr John Price, ASIC, *Proof Committee Hansard*, 6 March 2018, p. 12.

10 Ms Shellie Davis, Treasury, *Proof Committee Hansard,* 6 March 2018, p. 17.

11 Mr Stuart Stoyan, FinTech Australia, *Proof Committee Hansard*, 6 March 2018, p. 7; and FinTech Australia, *Submission to the Treasury Consultation on the Enhanced Regulatory Sandbox*, [pp.1–2].

12 Mr Stuart Stoyan, FinTech Australia, *Proof Committee Hansard*, 6 March 2018, p. 7.

> used (as appears to be the case with the existing model), thereby denying innovative FinTech firms the valuable opportunity to market test their products and services in a systematic, controlled manner.[13]

2.15 As an alternative to an assessment process to enter the sandbox, CHOICE, CALC and FRLC advocated for proposed Product Intervention Powers (PIPs) to be extended to the enhanced regulatory sandbox so that ASIC can intervene proactively if they find sandbox participants offering harmful products or services:

> A sandbox-specific PIP should allow ASIC to act quickly if harmful products or services are sold. This should allow ASIC to impose additional disclosure obligations, mandate warning statements, require amendments to advertising, or in extreme cases restrict or ban the distribution of any product or service in the sandbox.[14]

2.16 While not directly addressing the proposal for extending PIPs to the regulatory sandbox, Mr Price outlined the investor protections and mechanisms in the existing sandbox which would be extended to the enhanced sandbox:

> …there are a variety of important investor protection mechanisms…there are various conduct and disclosure obligations that are retained and…there is a professional indemnity insurance requirement…Also very important is membership of an external dispute resolution body so, if there is a dispute, there's a quick and easy mechanism by which consumers can seek recourse.[15]

2.17 Ms Greenall-Ota, Principal Adviser from Treasury, further indicated that the consumer protections were adequate and appropriate:

> We are satisfied the protections in place that are required to be maintained—the internal dispute resolution procedures, membership with external dispute resolution and adequate compensation arrangements, which include professional indemnity insurance with a run-off period of additional months—in addition to the ongoing protections that are also included to be within the sandbox, including best-interest duties, client money obligations and responsible lending obligations, are adequate protections to address the products that have been considered to be within the scope of the sandbox.[16]

Stakeholder views on the venture capital tax concession amendments (Schedule 2)

2.18 AVCAL was the only stakeholder that commented on the amendments to the venture capital tax concessions:

> AVCAL strongly supports the Government's proposed technical amendments to clarify certain aspects of the tax rules relating to ESVCLP and VCLP investment. We are pleased that a number of the issues that

13 Australian Private Equity and Venture Capital Association Limited, *Submission 3,* p. 2.

14 CHOICE, CALC and FRLC, *Submission 1,* p. 4.

15 Mr John Price, ASIC, *Proof Committee Hansard*, 6 March 2018, p. 14.

16 Ms Greenall-Ota, Treasury, *Proof Committee Hansard*, 6 March 2018, p. 16.

> AVCAL has raised with Treasury over the course of 2017 have been appropriately addressed in the bill.[17]

2.19 That said, AVCAL raised concerns that some aspects of the venture capital tax concession regime were still not consistent with the policy intent of the legislation:

> For example, the current drafting of the bill appears to affirm that the ESIC [early stage innovation company] tax offset amount that can be claimed through a partnership or trust is capped at $200,000 annually—for example, if a trust has ten members with an equal share, only $20,000 could be flowed-through to each of them per year. However, this does not appear consistent with our understanding of the policy intent—i.e. that the monetary cap should apply at an individual taxpayer level, and that there should be the same effect whether investment takes place directly or indirectly.[18]

2.20 As such, while not withstanding their support for the bill, AVCAL indicated that further amendments could be made to reduce uncertainty for the private equity and venture capital industry.[19]

Committee view

2.21 The committee notes that Schedule 1 sets the framework for the enhanced regulatory sandbox for financial innovation. The details of how the enhanced regulatory sandbox is implemented will be largely contained in the associated regulations which have yet to be finalised. However, as these regulations will be a disallowable instrument, the committee notes that the Parliament will have an opportunity to review them when they are finalised.

2.22 In relation to the minor amendments in Schedule 2, the committee is satisfied that these amendments are required to ensure the tax concessions for venture capital and early stage investors are operating as originally intended.

Recommendation 1

2.23 The committee recommends that the bill should be passed.

Senator Jane Hume

Chair

17 AVCAL, *Submission 3*, p. 2.

18 AVCAL, *Submission 3*, p. 2.

19 AVCAL, *Submission 3*, p. 3.

Additional Comments from Labor Senators

1.1 Labor Senators wish to make only brief remarks in addition to the Chair's report. Labor Senators thank the Chair for facilitating this inquiry.

Schedule 1 – Amendments to the FinTech Sandbox

1.2 Labor Senators note comments by FinTech Australia expressing disappointment with the current sandbox arrangements:

> I think it's fair to say that, from a FinTech Australia perspective, the sandbox outcome to date has been disappointing. We understand that just four fintechs have relied on the exemption to date, and we argue that it's the construct of the original sandbox that was excessively rigid in its approach.[1]

1.3 Labor Senators support the position of consumer groups, such as CHOICE, that fintech companies be required to be assessed by ASIC before being allowed entry into the sandbox. Labor Senators agree with Choice that the two major tests on entry should be that the company wants to test something that is:

a) genuinely innovative; and

b) provides a consumer benefit.[2]

1.4 Labor Senators note that FinTech Australia also supported a test on entry:

> Having an official review or a screen is definitely something that we would be supportive of to ensure that only appropriate companies or businesses were able to enter the sandbox…
>
> To the question that was asked earlier as to whether or not this needs to be beneficial or not detrimental, we'd argue not detrimental is a good outcome, and how you define beneficial also goes to that. It may be that it's a similar economic outcome for a consumer but just delivered in a much more user-friendly, favourable, time efficient manner, which will create benefits in other manners.[3]

Schedule 2 – the closure of tax loopholes

1.5 Treasury officials confirmed that this legislation has been introduced because of tax arrangements that are not in line with the original policy intent:

> We find that there are certain arrangements which come to our attention, often due to interpretations they've evolved in respect of the law. In this case we're making minor technical amendments to rectify some anomalies where taxpayers are applying the law in a way that's slightly inconsistent to what was originally intended under the law…

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1 Mr Stuart Stoyan, *Committee Hansard*, p. 5.

2 Choice, Consumer Action Law Centre & Financial Rights Legal Centre, *Submission 1*, p. 4.

3 Mr Stuart Stoyan, *Committee Hansard*, p. 6.

> In respect of the early-stage venture capital limited partnerships, we provide a tax incentive of 10 per cent on eligible investments in those vehicles. We intended for that offset to be 10 per cent. Stakeholders raised that there may be certain situations where that offset was being accessed in addition to the offset for early-stage innovation companies. That was not intended under the law.[4]

1.6 Treasury officials confirmed that the original 2016 legislation, particularly angel investor tax incentives, was based on the UK's Seed Enterprise Investment Scheme:

> Yes, I understand that they were based on the Seed Enterprise Investment Scheme.[5]

1.7 One of the key differences between the UK and Australian arrangements is that the Australian Government allowed trusts and companies to access the Angel Tax Incentive. While Treasury officials took on notice the question about whether this loophole was due to a failure of the 2016 legislation and to confirm that this loophole does not exist in the UK legislation, the Government has not ruled out that the legislation in this bill is intended to rectify a mistake of its own making. Put simply, it appears at this stage that the Government deliberately chose to ignore certain elements of the UK arrangements and this potentially opened up a tax loophole that they are now seeking to close.

1.8 If true, it is incumbent on the Government to acknowledge to this mistake before this bill is debated in the Parliament.

Position of Labor Senators

1.9 Labor Senators are supportive of the principles of the FinTech Sandbox. Labor Senators continue to hold the view that there should be adequate protections for consumers, and notwithstanding this, that the fintech sector and the regulatory sandbox holds promise in challenging the status of the major banks and can help to provide new products and services that improve the welfare of ordinary Australians.

1.10 Labor Senators are supportive of this bill, but reiterate their view that there should be an entry requirement to the sandbox based on the principles of genuine innovation and beneficial consumer outcomes.

1.11 Labor Senators also believe, given international precedents for regular reviews of Fintech Sandbox arrangements and the slow Australian adoption rate, that Australia's Fintech Sandbox should be reviewed in 12 months to evaluate consumer outcomes and whether the current regulatory arrangements are suitable for fintech companies.

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4 Mr Greg Derlacz, *Committee Hansard*, p. 17.

5 Mr Greg Derlacz, *Committee Hansard*, p. 18.

Recommendation 1

1.12 To amend the bill to include a mandatory review mechanism for the enhanced FinTech Sandbox starting no later than 12 months after Royal Assent.

Senator Chris Ketter
Deputy Chair

Senator Jenny McAllister
Senator for New South Wales

Appendix 1
Submissions and additional documents

Submissions

1 CHOICE, Consumer Action Law Centre and Financial Rights Legal Centre
2 Australian Securities and Investments Commission (ASIC)
3 Australian Private Equity & Venture Capital Association Limited (AVCAL)

Answers to questions on notice

1 Answers to questions on notice from a public hearing held in Melbourne on 6 March 2018, received from Treasury on 14 March 2018.

Appendix 2
Public hearings

Melbourne, 6 March 2018

Members in attendance: Senators Hume, Ketter.

ADAMS, Mr Mark, Senior Executive Leader, Australian Securities and Investment Commission

DAVIS, Ms Shellie, Senior Adviser, Financial System Division, Markets Group, Department of the Treasury

DERLACZ, Mr Gregory (Greg), Senior Adviser, Individuals and Indirect Tax Division, Revenue Group, Department of the Treasury

GREENALL-OTA, Ms Julie, Principal Adviser, Financial System Division, Markets Group, Department of the Treasury

PRICE, Mr John, Commissioner, Australian Securities and Investment Commission

STOYAN, Mr Stuart, Chair, FinTech Australia

TURNER, Ms Erin, Director, Campaigns and Communications, CHOICE