2016-2017

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TREASURY LAWS AMENDMENT (2017 MEASURES NO.1) BILL 2017

EXPLANATORY MEMORANDUM

Circulated by authority of the
Minister for Revenue and Financial Services, the Hon Kelly O'Dwyer MP)

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

Abbreviation	***Definition***
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 2001*
ITAA 1997	*Income Tax Assessment Act 1997*
CGT	capital gains tax
ESVCLP	Early Stage Venture Capital Limited Partnership

General outline and financial impact

Amendments to innovation measures

Schedule 1 to this Bill makes minor technical changes to the income tax law to ensure the National Innovation and Science Agenda measures contained in *Tax Laws Amendment (Tax Incentives for Innovation) Act 2016* operate in accordance with their original policy intent.

Date of effect: The amendments relating to the tax incentives for early stage investors measure apply to capital gains tax events occurring on or after 1 July 2017. The amendments relating to the venture capital investment measure apply in relation to payments made on or after 1 July 2016.

Proposal announced: The measures contained in *Tax Laws Amendment (Tax Incentives for Innovation) Act 2016* formed part of the National Innovation and Science Agenda, announced in the Government's Innovation Statement on 7 December 2015.

Financial impact: These amendments are estimated to have no revenue impact over the forward estimates period.

Human rights implications: This Schedule does not raise any human rights issues. See *Statement of Compatibility with Human Rights* — paragraphs 1.23 to 1.26.

Compliance cost impact: Nil.

Amendment of the *Australian Securities and Investments Commission Act 2001*

Schedule 2 to this Bill amends the *Australian Securities and Investments Commission Act 2001* to allow the Australian Securities and Investments Commission to more readily share confidential information with the Commissioner of Taxation

Date of effect: The day after Royal Assent.

Proposal announced: The amendment was announced in the 2016-17 Budget, along with the establishment of the Tax Avoidance Taskforce. Public consultations took place between 9 December 2016 and 13 January 2017.

Financial impact: The amendment in schedule 2 does not have a financial impact.

Human rights implications: This schedule raises human rights issue. See *Statement of Compatibility with Human Rights* — paragraphs 2.18 to 2.28.

Compliance cost impact: None.

Chapter 1
Amendments to innovation measures

Outline of chapter

1.1 Schedule 1 to this Bill makes minor technical changes to the income tax law to ensure the National Innovation and Science Agenda measures contained in *Tax Laws Amendment (Tax Incentives for Innovation) Act 2016* operate in accordance with the original policy intent.

1.2 All legislative references in this Chapter are to the *Income Tax Assessment Act 1997* (ITAA 1997), unless otherwise stated.

Context of amendments

1.3 The *Tax Laws Amendment (Tax Incentives for Innovation) Act 2016* amended the tax law to implement the following two National Innovation and Science Agenda measures to:

- provide concessional tax treatment for investments in innovative, high-growth potential startups (tax incentives for early stage investors measure); and
- reform tax arrangements for venture capital limited partnerships to improve access to capital, and make the regime more user-friendly and more internationally competitive (venture capital investment measure).

1.4 The amendments in *Tax Laws Amendment (Tax Incentives for Innovation) Act 2016* generally apply for the 2016-17 income year and later years.

1.5 Currently, investors that invest through an interposed trust are not able to access the capital gain concessions provided by these two measures, as intended.

Summary of new law

1.6 These amendments make technical corrections to ensure the *Tax Laws Amendment (Tax Incentives for Innovation) Act 2016* operates in accordance with the original policy intent. The amendments ensure that investors that invest through an interposed trust are able to access the capital gain concessions provided by the tax incentives for early stage investors and venture capital investment measures.

Detailed explanation of new law

Tax incentives for early stage investors measure

1.7 The tax incentives for early stage investors measure provided concessional capital gains tax (CGT) treatment for investors holding certain shares in an early stage innovation company. Specifically, an investor that has continuously held the share for at least twelve months and less than ten years may disregard a capital gain arising from the share (refer subsection 360-50(4)). See Explanatory Memorandum for the *Tax Laws Amendment (Tax Incentives for Innovation) Act 2016* for further information.

1.8 This concessional CGT treatment is intended to be available to all types of investors, regardless of their preferred method of investment (whether an investment is made directly by a corporation or individual or indirectly through a trust or partnership) other than ‘widely held companies’ (as defined in section 995-1) and 100 per cent subsidiaries of widely held companies.

1.9 However, prior to the amendments made by this Schedule, if an investor invests in an early stage innovation company indirectly through a trust, CGT event E4 would apply to claw back any disregarded capital gains that are later distributed through the trust. In particular, CGT event E4 would result in the CGT cost base of the unit or interest in the trust held by the investor being reduced by the amount of the distribution. If this would reduce the cost base of the unit or interest below zero, the cost base is reduced to zero and the investor has a capital gain equal to the balance of the amount (section 104-70).

1.10 These amendments ensure that investors that invest through an interposed trust are able to access the capital gain concessions provided by the tax incentives for early stage investors measure, as intended. This is achieved by modifying CGT event E4 by including amounts that are disregarded under subsection 360-50(4) in the list of amounts that are excluded when applying CGT event E4 under section 104-71. ***[Schedule 1, item 4, paragraph 104-71(3)(e)]***

1.11 Accordingly, CGT consequences do not arise under CGT event E4 for a beneficiary in respect of the beneficiary's share of a capital gain that is disregarded because of these tax concessions.

1.12 This ensures that the same CGT outcome arises for the investors in an early stage innovation company, regardless of whether they invest directly or indirectly, such as through a fixed trust (including a unit trust) or a discretionary trust. That is, such investors will have access to the modified CGT treatment under subsection 360-50(4) in the same way a direct investor in an early stage innovation company would.

1.13 However, these amendments only have application in relation to payments made to an investor directly from a trust that holds the interest in an early stage innovation company. These amendments do not apply to payments made to an investor from a trust where that trust is the beneficiary of the underlying trust which holds the interest in the early stage innovation company. That is, the members of that other trust will not have access to the modified CGT treatment under subsection 360-50(4) in relation to the receipt of a distribution of capital proceeds.

1.14 Extending the tax incentives for early stage investors measure to indirect investments held through another vehicle may be considered at a later date. The Government intends to review this tax incentive after a period to determine how well it is delivering on its policy outcomes.

Venture capital investment measure

1.15 The Early Stage Venture Capital Limited Partnership (ESVCLP) regime was introduced in 2007 to provide tax concessions for early stage venture capital activities. An ESVCLP is taxed on a 'flow through' basis, rather than being treated as a company for tax purposes like other limited partnerships (see subsection 94D(2) of the *Income Tax Assessment Act 1936*). Under the ESVCLP regime, investors are exempt from income tax on capital and revenue gains from disposals of investments made by the ESVCLP. Corresponding losses are also disregarded (sections 51-54 and 118-407). Income derived from the partnership, such as from dividends, is also exempt from income tax (section 51-52).

1.16 The venture capital investment measure included amendments modifying CGT event E4 by adding amounts that are exempt or disregarded under the ESVCLP tax concessions in sections 51-54 and 118-407 to the list of amounts that are excluded when applying CGT event E4 under section 104-71. See the Explanatory Memorandum for the

Tax Laws Amendment (Tax Incentives for Innovation) Act 2016 for further information.

1.17 The amendments in this Schedule add amounts that are exempt under the ESVCLP tax concessions in section 51-52 to the list of amounts that are excluded when applying CGT event E4 under section 104-71. This ensures that CGT consequences do not arise under CGT event E4 for a partner in a limited partnership or a partner in an Australian venture capital fund of funds in relation to the partner's share of income derived from a partnership that is exempt because of the ESVCLP tax concessions in section 51-52. ***[Schedule 1, item 1, paragraph 104-71(3)(aa)]***

1.18 The amendments also clarify the language of the provisions to ensure there is no ambiguity about the venture capital tax concessions, including the ESVCLP tax concessions being available to beneficiaries. This clarification addresses concerns that the reference to amounts exempt in the hands of the ESVCLP might make it inapplicable in most cases, as the ESVCLP is taxed on a 'flow through' basis, with the exemption applying to amounts that pass through to the partners. The amendments ensure that CGT consequences do not arise for a beneficiary in respect of the beneficiary's share of income derived from a partnership that is exempt because of the venture capital tax concessions. ***[Schedule 1, item 1, paragraph 104-71(3)(aa)]***

Inconsistent use of term 'capital proceeds' in the CGT rules

1.19 The Schedule also amends subsection 104-71(3) (which concerns modifications to CGT event E4) to change references from 'proceeds' to 'capital proceeds' to ensure consistency throughout the CGT rules in the ITAA 1997. ***[Schedule 1, items 2 and 3, paragraphs 104-71(3)(b), (c) and (d)]***

Application provisions

1.20 The amendments relating to the tax incentives for early stage investors measure apply to a CGT event that happens on or after 1 July 2017. ***[Schedule 1, subitem 5(2)]***

1.21 The amendment relating to the venture capital investment measure applies in relation to payments made, in respect of a unit or an interest in a trust, in an income year starting on or after 1 July 2016. ***[Schedule 1, subitem 5(1)]***

1.22 The retrospective application of the amendment relating to the venture capital investment measure does not adversely affect the rights of affected taxpayers. The amendment corrects an unintended consequence and applies consistent with the intended operation of the law.

STATEMENT OF COMPATIBILITY WITH HUMAN RIGHTS

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

Amendments to innovation measures

1.23 This Schedule is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview

1.24 This Schedule makes technical changes to the income tax law to ensure that the *Tax Laws Amendment (Tax Incentives for Innovation) Act 2016* operates in accordance with the original policy intent. The amendments ensure that investors that invest through an interposed trust can access the capital gain concessions provided by the tax incentives for early stage investors and venture capital investment measures.

Human rights implications

1.25 This Schedule does not engage any of the applicable rights or freedoms.

Conclusion

1.26 This Schedule is compatible with human rights as it does not raise any human rights issues.

Chapter 2
Amendment of the Australian Securities and Investments Commission Act 2001

Outline of chapter

2.1 Schedule 2 to the Bill will amend the *Australian Securities and Investments Commission Act 2001* (the ASIC Act) to allow the Australian Securities and Investments Commission (ASIC) to more readily share confidential information with the Commissioner of Taxation. The amendment will assist both ASIC and the Commissioner of Taxation to perform their functions in a more timely and effective manner.

Context of amendments

2.2 ASIC has a range of powers to gather information and documents as part of its role in regulating Australian companies, financial markets and financial services organisations and professionals who deal and advise in investments, superannuation, insurance, deposit taking and credit.

2.3 ASIC uses the information and documents gathered to ensure compliance with the law and to take enforcement action where necessary.

2.4 There are strict confidentiality rules around the use and disclosure of the information ASIC obtains. Under section 127 of the ASIC Act, ASIC must take all reasonable measures to protect confidential information it receives as part of its statutory functions from unauthorised use or disclosure.

2.5 ASIC is, however, authorised to share the confidential information it obtains with certain prescribed individuals and entities, including the relevant Minister, the Reserve Bank of Australia and the Australian Prudential Regulation Authority (section 127(2A) of the ASIC Act).

2.6 The ASIC Act also permits ASIC to share the information with other agencies and regulatory bodies where the ASIC Chairperson is satisfied that it will enable or assist them to perform their functions or exercise their powers.

2.7 At present, in order for ASIC to be able to share information with the Commissioner of Taxation, the ASIC Chairperson, or their delegate, must be satisfied that doing so would enable or assist the Commissioner of Taxation to perform or exercise their functions or powers. This is in addition to the Commissioner of Taxation being satisfied that they have authority to receive and utilise the information.

2.8 This process causes inefficiencies and hinders effective collaboration between the agencies in ensuring compliance and investigating potential illegal activity.

2.9 Where ASIC has shared information with the Commissioner of Taxation, the information remains protected from unauthorised disclosure as Division 355 of Schedule 1 to the *Taxation Administration Act 1953* makes the unauthorised disclosure of confidential information an offence.

Summary of new law

2.10 The new law amends the ASIC Act to specify that the sharing of confidential ASIC information with the Commissioner of Taxation is authorised use and disclosure of that information.

Comparison of key features of new law and current law

New law	***Current law***
ASIC is authorised to share confidential information with the Commissioner of Taxation. Confidential information shared with the Commissioner of Taxation remains protected from unauthorized disclosure.	A confidentiality provision prohibits ASIC from sharing confidential information with the Commissioner of Taxation, unless the Chairperson, or their delegate, is satisfied that the information will enable or assist the Commissioner of Taxation to perform or exercise their functions or powers.

Detailed explanation of new law

2.11 The new law adds the Commissioner of Taxation to the entities listed in subsection 127(2A) of the ASIC Act to which disclosure of confidential information is authorised. ***[Schedule 2, item 1, subsection 127(2A)]***

2.12 The reference to the Commissioner of Taxation includes the Commissioner in all their capacities as the Commissioner of Taxation.

2.13 As a result of this amendment, ASIC will be authorised to provide the Commissioner of Taxation with information it holds that is protected or that is given to it in confidence in connection with the performance of its functions or exercise of its powers. The amendment simplifies the process and creates efficiencies by allowing information to be shared without the Chairperson's, or their delegate's, involvement.

2.14 The new law enables ASIC to more effectively share information with the Commissioner of Taxation, enabling more timely collaboration during investigations into illegal or high risk activities. Simplifying the process for information sharing will also enable both agencies to ensure compliance with laws and identify patterns of non-compliance.

2.15 The amendment enables a simpler process for ASIC to share information with the Commissioner of Taxation, which mirrors the existing arrangement for sharing information between ASIC and the Reserve Bank of Australia, the Australian Prudential Regulation Authority and the relevant Minister.

Application and transitional provisions

2.16 ASIC will be authorised to disclose information to the Commissioner of Taxation following the commencement of the Schedule. This applies in relation to disclosure of any information held by ASIC at that time regardless of whether it was obtained before or after this amendment commences. ***[Schedule 2, item 2, section 302]***

2.17 The amendment is prospective because it only authorises the disclosure of information after commencement.

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

Treasury Laws Amendment (2017 Measures No.1) Bill 2017

2.18 This Schedule is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview

2.19 Schedule 2 to the Bill amends the *Australian Securities and Investments Commission Act 2001* (the ASIC Act) to allow the Australian Securities and Investments Commission (ASIC) to more readily share confidential information with the Commissioner of Taxation.

Human rights implications

2.20 Schedule 2 engages the right to protection from unlawful or arbitrary interference with privacy under Article 17 of the International Covenant on Civil and Political Rights (ICCPR) because it provides a more streamlined process for ASIC to share confidential information with the Commissioner of Taxation.

2.21 Under the existing law, ASIC can disclose confidential information to other Australian government agencies, including the Commissioner of Taxation, where the ASIC Chairperson (or delegate) is satisfied that it will enable or assist them to perform their functions and exercise their powers.

2.22 The amendment streamlines the process by providing a more efficient mechanism for ASIC to share confidential information with the Commissioner of Taxation. It will improve the Commissioner of Taxation's ability to conduct timely compliance activity and better protect the integrity of Australia's tax system.

2.23 The amendment to the process for ASIC to share information with the Commissioner of Taxation mirrors the existing power for the Commissioner of Taxation to share confidential information with ASIC under Division 355 of Schedule 1 to the *Taxation Administration Act 1953*. Mirroring the information sharing process between ASIC and the Commissioner of Taxation will enable effective and timely collaboration during investigations into illegal and high risk activities. The amendment is a reasonable change as it will allow ASIC and the Commissioner of Taxation to more effectively work together to ensure compliance with corporate and taxation laws.

2.24 Furthermore, the amendment is appropriate as it will ensure that the process for ASIC to share confidential information with the Commissioner of Taxation is consistent with the process for ASIC to share confidential information with the Reserve Bank of Australia, the Australian Prudential Regulation Authority and the relevant Minister.

2.25 Although ASIC will not need to determine that particular information would enable or assist the Commissioner of Taxation to perform or exercise their functions or powers, the Commissioner of Taxation will remain restricted in the information they can seek by the scope of their authority to receive and utilise information in carrying out their role.

2.26 Any information that is shared between ASIC and the Commissioner of Taxation will remain subject to strict confidential protections. ASIC will remain subject to the requirement to take all reasonable measures to protect confidential information from any unauthorised disclosure. Where ASIC has shared information with the Commissioner of Taxation, the information will remain protected from unauthorised disclosure as Division 355 of Schedule 1 to the *Taxation Administration Act 1953* makes the unauthorised disclosure of confidential information an offence.

Conclusion

2.27 The amendment to simplify the process to share information in Schedule 2 is consistent with Article 17 of the ICCPR because, to the extent the amendment authorises the disclosure of confidential information by ASIC to the Commissioner of Taxation, this is already permitted. The amendment replicates existing information sharing arrangements ASIC has with other agencies to ensure consistency and streamlines administrative processes.

2.28 A simpler and more efficient information sharing arrangement between ASIC and the Commissioner of Taxation is justified as it will benefit the community by enabling better monitoring of illegal and other high-risk activities by the Commissioner of Taxation and strengthen corporate compliance with taxation law.

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Schedule 1: Amendments to innovation measures

Bill reference	***Paragraph number***
Item 1, paragraph 104-71(3)(aa)	1.17, 1.18
Items 2 and 3, paragraphs 104-71(3)(b), (c) and (d)	1.19
Item 4, paragraph 104-71(3)(e)	1.10
Subitem 5(2)	1.20
Subitem 5(1)	1.21

Schedule 2: Amendment of the *Australian Securities and Investments Commission Act 2001*

Bill reference	***Paragraph number***
Item 1, subsection 127(2A)	2.11
Item 2, section 302	2.16