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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TAX LAWS AMENDMENT (2007 MEASURES No. 2) BILL 2007

EXPLANATORY MEMORANDUM

(Circulated by authority of the
Treasurer, the Hon Peter Costello MP)

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Glossary

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

Abbreviation	***Definition***
ABS	Australian Bureau of Statistics
AFOFs	Australian venture capital funds of funds
ATO	Australian Taxation Office
CGT	capital gains tax
Commissioner	Commissioner of Taxation
DGR	deductible gift recipient
ESVCLP	early stage venture capital limited partnerships
GST	goods and services tax
ITAA 1936	*Income Tax Assessment Act 1936*
ITAA 1997	*Income Tax Assessment Act 1997*
JORC Code	the Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves
PDF Act	*Pooled Development Funds Act 1992*
PDFs	pooled development funds
R&D	research and development
VC Act	*Venture Capital Act 2002*
VCLP	venture capital limited partnerships
VCR Board	Venture Capital Registration Board

General outline and financial impact

Effective life provisions

Schedule 1 to this Bill amends the provisions of the *Income Tax Assessment Act 1997* relating to depreciating assets under the uniform capital allowance system. These amendments will more closely align the decline in value deductions for mining, quarrying and prospecting rights with that for other depreciating assets.

Date of effect: These amendments apply to assessments for the income year in which 1 July 2001 occurred, and to later income years. This date was the commencement date of the uniform capital allowance system. This does not disadvantage taxpayers as the intent of the law has always been followed and this measure clarifies the law.

Proposal announced: This measure was announced in the Minister for Revenue and Assistant Treasurer's Press Release No. 021 of 9 May 2006.

Financial impact: Nil.

Compliance cost impact: Nil.

Taxation of boating activities

Schedule 2 to this Bill changes the taxation treatment of boating activities. These changes allow taxpayers who cannot demonstrate that they are carrying on a business using a boat to claim deductions for boating expenses up to the level of their boating income.

Date of effect: These amendments apply to the first income year starting on or after the day on which this Bill receives Royal Assent, and to later income years.

Proposal announced: This measure was announced in the Minister for Revenue and Assistant Treasurer's Press Release No. 022 of 9 May 2006.

Financial impact: This measure will have these revenue implications:

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

Compliance cost impact: This measure is expected to impose minor compliance costs because taxpayers need to account for boating expenses to benefit from the measure.

Certain expenditure on research and development activities

Schedule 3 to this Bill amends the provisions of the *Income Tax Assessment Act 1936* relating to expenditure on research and development (R&D). These amendments clarify and make 10 technical amendments to the provisions for the premium incremental concession and the refundable R&D tax offset.

Date of effect: These amendments are technical in nature and have various dates of effect.

Proposal announced: This measure was announced on 9 May 2006 in the 2006-07 Budget.

Financial impact: 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.

Compliance cost impact: Negligible. As this measure clarifies and makes technical amendments to the law it is not anticipated to impact on the compliance costs for R&D companies.

Donation of listed shares to deductible gift recipients

Schedule 4 to this Bill amends the *Income Tax Assessment Act 1997* to allow a tax deduction for donations of publicly listed shares, to eligible deductible gift recipients, acquired more than 12 months before gifting and valued at $5,000 or less.

Date of effect: This measure applies in an income year commencing on or after the date of Royal Assent.

Proposal announced: This measure was announced in the Minister for Revenue and Assistant Treasurer's Press Release No. 019 of 9 May 2006.

Financial impact: This measure will have these revenue implications:

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

Compliance cost impact: Nil.

Deductible gift recipients

Schedule 5 to this Bill amends the *Income Tax Assessment Act 1997* to update the list of deductible gift recipients (DGRs).

Date of effect: Deductions for gifts to the following organisations that are listed as DGRs under this Schedule, apply as follows:

- American Australian Association Limited from 14 November 2006; and
- Bunbury Diocese Cathedral Rebuilding Fund from 19 December 2006 until 18 December 2008.

In addition, this Schedule extends the DGR listing of The Finding Sydney Foundation to 27 August 2007.

Proposal announced: The deductibility of gifts to the American Australian Association Limited was announced in the Prime Minister's Media Release of 14 November 2006.

The deductibility of gifts to the Bunbury Diocese Cathedral Rebuilding Fund was announced in the Minister for Revenue and Assistant Treasurer's Press Release No. 098 of 22 December 2006.

The extension for the deductibility of gifts to The Finding Sydney Foundation was announced in the Minister for Revenue and Assistant Treasurer's Press Release No. 082 of 10 November 2006.

Financial impact: This measure will have these revenue implications:

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

Compliance cost impact: Nil.

Deductions for contributions relating to fund-raising events

Schedule 6 to this Bill amends the *Income Tax Assessment Act 1997* to extend the eligibility for tax deductions for contributions to deductible gift

recipients, where an associated minor benefit is received for an eligible fund-raising event.

Date of effect: These amendments apply to contributions made on or after 1 January 2007.

Proposal announced: These amendments were announced jointly by the Minister for Revenue and Assistant Treasurer and the Minister for Families, Community Services and Indigenous Affairs, in Press Release No. 086 of 1 December 2006.

Financial impact: This measure will have these revenue implications:

2007-08	***2008-09***	***2009-10***
–$1.5m	–$6m	–$6m

Compliance cost impact: Nil.

Technical amendments and corrections

Schedule 7 to this Bill addresses a defect in the definitions of 'exempt entity' in the *Income Tax Assessment Act 1997* (ITAA 1997) and 'excepted trust' in the *Income Tax Assessment Act 1936*. It also corrects some minor technical errors in Division 58 of the ITAA 1997.

Date of effect: These amendments apply from 1 July 2005. Transitional rules ensure that taxpayers are not retrospectively disadvantaged.

Proposal announced: Not previously announced.

Financial impact: Nil.

Compliance cost impact: This measure is expected to reduce compliance costs because it corrects a defect in the current law, reducing uncertainty.

Venture capital

Schedule 8 to this Bill amends the venture capital regime by:

- relaxing the eligibility requirements for concessional taxation treatment for foreign residents investing in venture capital limited partnerships (VCLPs) and Australian venture capital funds of funds (AFOFs); and

- providing taxation concessions for Australian residents and foreign residents investing in early stage venture capital activities through a new investment vehicle called an early stage venture capital limited partnership (ESVCLP).

Amendments are made to close the pooled development fund (PDF) scheme to new applications as a result of the introduction of the ESVCLP investment vehicle.

A technical amendment is also made to the regime in relation to the conditional registration of VCLPs and AFOFs.

Date of effect: Parts 1 to 4 apply to the 2007-08 income year and all later years. Part 5 applies from the commencement of the *Venture Capital Act 2002*.

Proposal announced: This measure was announced in the Treasurer's Press Release No. 37 of 9 May 2006.

Financial impact: This measure will have these revenue implications:

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

Compliance cost impact: Small.

Summary of regulation impact statement

Regulation impact on business

Impact: This measure will impact on:

- small and medium entities seeking capital injections to finance the future activities of relatively high risk and expanding businesses;

- Australian resident investors — they will be tax-exempt on income and profits and capital gains made by ESVCLPs in which they are partners;

- general partners of ESVCLPs — they will be entitled to the carried interest tax concession which will be exempt from tax; and

- general partners of VCLPs — they will have more investment choices.

Main points:

- The operation of the VCLP regime is to be enhanced by removing or relaxing unnecessary restrictions. These changes:
  - remove restrictions on the country of residence of limited partners;
  - reduce the required minimum capital from $20 million to $10 million;
  - allow investment in unit trusts and convertible notes as well as shares and options;
  - allow the appointment of auditors to investee entities to occur at the end of the financial year in which the investment is made; and
  - allow up to 20 per cent of a VCLP's committed capital to be invested in companies and unit trusts that do not satisfy the residency requirements.
- An ESVCLP regime will be introduced to provide an investment vehicle targeted at ESVCLPs. These partnerships will provide flow through tax treatment and a complete tax exemption for income, both revenue and capital, received by its domestic and foreign partners. The regime will progressively replace the PDF programme which provides tax concessions to investors carrying on eligible activities in eligible small and medium sized companies.

Chapter 1
Effective life provisions

Outline of chapter

1.1 Schedule 1 to this Bill amends Division 40 of the *Income Tax Assessment Act 1997* (ITAA 1997) to more closely align the decline in value deductions for mining, quarrying and prospecting rights (mining rights) with that for other depreciating assets.

Context of amendments

1.2 Division 40 of the ITAA 1997, provides for a uniform capital allowance system that establishes general rules that, among other things, allow deductions for the decline in value of depreciating assets based on their effective lives. The 'effective life' of a depreciating asset is generally the estimated period the asset can be used by any entity for a taxable purpose or for the purpose of producing exempt income or non-assessable non-exempt income. The uniform capital allowance system was enacted with effect from 1 July 2001.

1.3 Taxpayers, in calculating deductions for the decline in value of their depreciating assets, generally have the choice either to use the Commissioner of Taxation's (Commissioner) 'safe harbour' determinations, or they can self-assess the effective lives of their assets. If they self-assess, they must, if relevant for the asset, have regard to the wear and tear reasonably expected from their circumstances of use and assume the asset will be maintained in reasonably good order and condition.

1.4 The Commissioner publishes determinations of effective life for numerous depreciating assets used in a wide range of industries. The Commissioner has an on-going review which continually updates the 'safe harbour' effective lives determinations.

1.5 If a Commissioner's determination is not in force for a particular asset, taxpayers generally must self-assess the effective life of that asset.

1.6 Once they have worked out their asset's effective life, taxpayers can generally work out their decline in value deductions using either the prime cost method or diminishing value method.

1.7 The Commissioner's determination is based on the asset being new when it starts being used. A taxpayer purchasing a second-hand asset for use for a taxable purpose (eg, item of machinery), will generally have the choice either to still use the relevant 'safe harbour' effective life determined by the Commissioner (notwithstanding that it is based on the asset being new) or self-assess the asset's effective life by estimating the period the second-hand asset can be used by any entity for the relevant purposes set out in paragraph 1.2.

1.8 Certain intangible depreciating assets listed in the table in subsection 40-95(7) do not use those general rules. The uniform capital allowance system prescribes statutory effective lives for these intangible assets and stipulates (in subsection 40-70(2)) that the diminishing value method cannot apply to most of them. Therefore, the prime cost method must be used to calculate their decline in value.

1.9 Although mining rights were included in the table in subsection 40-95(7), the diminishing value method can still be applied to them, because subsection 40-70(2) does not include mining rights as one of those intangible assets where the diminishing value method cannot apply. Mining rights were included in the table in items 11 to 13 in subsection 40-95(7) by the *Tax Laws Amendment Act (No. 4) 2003*. Those items expressly linked the effective life of the mining right to the life of the relevant 'mines', that is, existing or proposed mine or mines, petroleum field or quarry or quarries.

1.10 Unfortunately, including mining rights with other intangible assets in the table in subsection 40-95(7) resulted in mining rights being treated differently from both other depreciating assets out of the table and from other intangible assets in the table. This was not the intended outcome of the *Tax Laws Amendment Act (No. 4) 2003*.

Summary of new law

1.11 These amendments will remove mining rights from the table in subsection 40-95(7). Instead, the effective life of mining rights will be worked out under the new subsections 40-95(10) and (11) under broadly the same rules in the current law. A new rule will be introduced to clarify how to work out the life of a mine.

Comparison of key features of new law and current law

New law	*Current law*
Mining rights will be removed from the table in subsection 40-95(7) and the effective life of mining rights will be worked out under new subsections 40-95(10) and (11).	Specific rules apply to mining rights including expressly linking the effective life of a mining right to the life of the existing or proposed mine or mines to which the right relates.
A new rule will clarify how to work out the life of a mine.	These rules are covered in items 11 to 13 in the table in subsection 40-95(7).

Detailed explanation of new law

1.12 Mining rights will be removed from the table in subsection 40-95(7). ***[Schedule 1, item 1, items 11 to 13 in the table in subsection 40-95(7)]***

1.13 There was a possible interpretation that including mining rights in this table led, in cases where taxpayers chose the diminishing value method of working out the decline in value of their mining right, to the effective life of a mining right being based on the *whole* rather than *remaining* life of the existing or proposed mine or mines to which the right relates. In addition, there was an interpretation that holders of mining rights were required to assess the life of the right annually. These interpretations led to outcomes that were inconsistent with that for other depreciating assets under the uniform capital allowance system for which the diminishing value method of working out the decline in value is being used.

1.14 Under these changes, the treatment of mining rights will be more closely aligned with that for other depreciating assets. This means that a taxpayer acquiring their mining right from a prior holder will be able to estimate the remaining period until the end of the life of the existing or proposed mine or mines to which the right relates irrespective of whether the taxpayer chooses the prime cost or the diminishing value method of working out the decline in value of their mining right. As well, there will be no requirement for a taxpayer to undertake a yearly or periodic assessment of the effective life of their mining right.

1.15 Mining rights are to be excluded from the general rules that apply to self-assessing the effective life of a depreciating asset in section 40-105 because the effective life of a mining right relates to the estimated period until the end of the life of another asset — a mine. The capital costs of developing a mine are typically deductible over time. If

the capital costs do not create depreciating assets in their own right, then special provisions apply to this expenditure in Subdivision 40-I. Further, the general rules in section 40-105 require the taxpayer to estimate the period the depreciating asset can be used by any entity for various purposes including ‘a taxable purpose’. This term is defined in subsection 40-25(7) to not only include ‘the purpose of producing assessable income’ (which would be the dominant purpose during the life of the mine), but also ‘the purpose of exploration or prospecting’, ‘the purpose of mining site rehabilitation’ and ‘environmental protection activities’. However for mining rights the effective life relates to a shorter period, the period until the end of the life of the mine. ***[Schedule 1, item 4, subsection 40-105(4)]***

How the effective life of a mining right will be worked out

1.16 Taxpayers work out the effective life of their mining right themselves by estimating the period until the end of the life of the mine or proposed mine to which the right relates or, if there is more than one such mine, the life of the mine that has the longest estimated life, that is, the period until the end of the life of the only remaining mine. A proposed mine for the purposes of subsection 40-95(10) is where preparatory work to the actual extraction of the reserves has started at the site. It is a mine which may not be constructed at the time of acquisition of the mining right but for which a decision has been made by the acquiring company that the mine will be constructed. This would be expected to be evidenced by the approval of the proposed capital expenditure required to construct the mine infrastructure by the acquiring company’s board of directors. Likewise, when a mine is already under construction at the time of the acquisition of the mining right this would also represent a proposed mine for the purposes of subsection 40-95(10). A similar process applies if the right relates to mining operations to obtain quarry materials. There a taxpayer estimates the period until the end of the life of the quarry or proposed quarry to which the right relates or, if there is more than one quarry, the life of the quarry that has the longest estimated life, that is, the period until the end of the life of the only remaining quarry. However, if the mining right relates to mining operations to obtain petroleum, the effective life of that right is worked out by estimating the period until the end of the life of the petroleum field or proposed petroleum field. ***[Schedule 1, item 3, subsection 40-95(10)]***

1.17 The period in subsection 40-95(10) will be worked out from the start time of the mining right. ***[Schedule 1, item 3, paragraph 40-95(11)(a)]***

1.18 For the purposes of working out the period in subsection 40-95(10), the period until the end of the life of an existing or proposed mine will be worked out as the period over which the reserves

are expected to be extracted from the mine. This period is worked out by determining the amount of the reserves, reasonably estimated by a competent person using an appropriately accepted industry practice, *divided* by the expected extraction rate from the mine. Current examples of such accepted industry practices are:

- the *Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves* (referred to as the JORC Code). This is a code for mineral reporting prepared by the Joint Ore Reserves Committee of the Australasian Institute of Mining and Metallurgy, the Australian Institute of Geoscientists and the Minerals Council of Australia; and

- the *Guidelines for the Evaluation of Petroleum Reserves and Resources — (A Supplement to the SPE/WPC/ Petroleum Reserves Definitions and the SPE/WPC/AAPG Petroleum Resources Definitions)* published by the Society of Petroleum Engineers (SPE). The abbreviations used in the title above stand for the World Petroleum Council (WPC) and the American Association of Petroleum Geologists (AAPG).

[Schedule 1, item 3, paragraph 40-95(11)(b)]

1.19 As pointed out in paragraph 1.14, once the life of the mine has been estimated, there will be no requirement in the new law for a yearly or periodic re-estimation of the period until the end of the life of the mine and similarly, no requirement for a yearly or periodic re-estimation of the effective life of the mining right. However, as noted in paragraphs 1.22 to 1.26, there is the ability for the taxpayer to choose to reassess the effective life of the mining right, should they so decide.

1.20 The following examples help to illustrate how this measure will work.

Example 1.1

Black Stump Pty Ltd acquired the Lockyer Coal mine from one of its competitors on 1 July 2007. The mine is operated on a single mining right, issued by Queensland. Immediately following the acquisition Black Stump determines that the mine has ore reserves, calculated using the JORC Code, of 100 million tonnes. The use of the JORC Code to calculate ore reserves is the accepted practice in the Australian mining industry, and represents the 'reserves', for the purposes of paragraph 40-95(11)(b). Black Stump Pty Ltd has also determined that the average extraction rate of the ore reserves is expected to be 5 million tonnes per annum. Based on these estimates the life of the mine is calculated to be 20 years. This will be

the effective life of the mining right for the purposes of subsection 40-95(10).

Example 1.2

Mine Co. Pty Ltd acquired the Frontier copper deposits (F47 and F52) from one of its competitors on 1 December 2006. The deposits are located within the boundaries of a single mining right issued by New South Wales. Each of the deposits is currently extracted via separate open cut mines each with their own operational infrastructure. Immediately following the acquisition, Mine Co. Pty Ltd determined that the F47 deposit has ore reserves of 25 million tonnes and the F52 deposit has ore reserves of 50 million tonnes. The determination of these ore reserves was made using the JORC Code. Mine Co. Pty Ltd has also determined that the average extraction rate of the F47 ore reserves is expected to be 3 million tonnes per annum and the average extraction rate of the F52 ore reserves is expected to be 5 million tonnes per annum. Based on these estimates the life of the F47 mine is 8.3 years and the life of the F52 mine is 10 years. The mine with the longest estimated life is therefore F52 which has a mine life of 10 years. This will be the effective life of the mining right for the purposes of subsection 40-95(10).

Example 1.3

Barrel Oil Pty Ltd acquired a production licence from one of its competitors on 1 July 2007. It is Barrel Oil Pty Ltd's intention to continue extracting oil from the one existing oil field within that production licence. Immediately following the acquisition of the production licence, Barrel Oil Pty Ltd determines that the field has proved and probable developed and undeveloped oil reserves of 200 million barrels. The oil reserves have been calculated using accepted industry practices (eg, those recommended by the Society of Petroleum Engineers), through reference to available seismic well and reservoir information, production and pressure trends and data from other producing reservoirs in the immediate area. The proved and probable developed and undeveloped oil reserves represent the 'reserves', for the purposes of paragraph 40-95(11)(b). Barrel Oil Pty Ltd has also determined from the development plan that it had prepared at the time that it acquired the production licence, that it expected it would take 12 years to extract and process the recoverable reserves. The effective life of the mining right relating to mining operations to obtain petroleum is 12 years for the purposes of subsection 40-95(10).

Example 1.4

Bauxite Co. Pty Ltd acquires the Big W mine on 1 July 2005, which is contained on a single permit together with a proposed mine which has just commenced construction (the Big X mine). The Big W mine has

JORC Code reserves at 30 million tonnes which are being mined at 10 million tonnes per annum. Based on these calculations the life of the Big W mine is three years, and will close in 2008. The construction of the Big X mine is expected to be completed in 2008, when the Big W mine closes, and has JORC Code reserves of 200 million tonnes which will also be mined at 10 million tonnes per annum. Based on these calculations the life of the proposed mine is 20 years, and will close in 2028. As the Big X mine will close later than the Big W mine, the effective life of the permit will be 23 years (1 July 2005 until 1 July 2028).

How mining right decline in value deductions will be calculated

1.21 As with other assets, taxpayers will generally have the choice of using either the prime cost or diminishing value methods in calculating the decline in value of their mining right. Should the mining right be transferred, the new acquirer of that right will generally be allowed to work out the decline in value of their acquired right by estimating the remaining period until the end of the life of the mine or proposed mine to which the right relates (or, if there is more than one such mine, the life of the mine that has the longest estimated life), as illustrated in Example 1.4. Following this, taxpayers will choose either the prime cost method or diminishing value method to work out the right's decline in value. As with other depreciating assets, the transfer of the right will generally be considered to be a balancing adjustment event.

When the effective life of a mining right may be changed

1.22 The existing section 40-110 permits taxpayers to choose to recalculate the effective life of a depreciating asset in certain circumstances (subsection 40-110(1)), and mandates it in other circumstances (subsections 40-110(2) and (3)). Subsection 40-110(1) currently permits (but does not mandate) a taxpayer to recalculate the effective life of a depreciating asset if it is no longer accurate, because of changed circumstances relating to the nature of the use of the asset. This subsection will not be applicable for mining rights but it is to be supplemented by the addition of a subsection 40-110(3B), to permit the recalculation of the effective life of a mining right if it is no longer accurate because of changed circumstances relating to an existing or proposed mine. This recalculation is done using subsections 40-95(10) and (11), which means a re-estimation of the period from the mining right's start time until the end of the life of the mine. Circumstances that may cause a taxpayer to choose to make a re-estimation of the effective life of a mining right are discussed further in paragraph 1.25. ***[Schedule 1, item 5, subsection 40-110(3B)]***

1.23 The existing section 40-110 requires the recalculation to be undertaken using the principles in section 40-105 (about self-assessing effective lives). However, as noted in paragraph 1.15, mining rights are to be excluded from the general rules that apply to self-assessing the effective life of a depreciating asset in section 40-105. Accordingly any recalculation of the effective life of a mining right pursuant to section 40-110 must be undertaken using the principles set out in subsections 40-95(10) and (11) as described in paragraph 1.21. ***[Schedule 1, item 6, subsection 40-110(4)]***

1.24 By stating that the effective life of a mining right relates to the estimated period until the end of the life of the mine, this measure leaves it open for taxpayers to choose to re-estimate that period, if the original estimate is no longer accurate. Accordingly if a taxpayer chooses to undertake a re-estimation of the life of the mine this re-estimation will change the effective life of the mining right.

1.25 The actual period until the end of the life of the mine would, in most cases, be constantly changing. Despite this, there is no requirement in this measure for a regular or periodic re-estimation of the effective life of the mining right to be undertaken. Circumstances that may cause the taxpayer to choose to make a re-estimation of the effective life of a mining right would be varied, but could include:

- a considerable structural price change for the mineral being extracted which leads to the mine's premature permanent closure;
- previously uneconomically mineable geologies becoming economically mineable;
- a noticeable improvement in extraction methods or transport arrangements from the mine which leads to faster extraction of the mineral and a consequential shortening of the remaining life of the mine;
- new information becoming available as a result of further exploration or prospecting on the mining tenement as to the presence of minerals likely to be recoverable which leads to an increase in the remaining life of the mine; or
- a change to the accepted industry practice that affects the estimation of the life of the mine.

1.26 Subsections 40-110(2) and (3) will also not apply to mining rights. Although capital expenditure is being incurred at the mine in the normal course of the extraction process, this expenditure has rarely any

relation to the cost of the mining right itself. From an economic point of view, and all other economic factors being equal, the taxpayer will try to extract the reserves as quickly as possible. Therefore capital expenditure incurred other than in the course of the extraction process is, generally, directed at facilitating or improving the efficiency of the extraction process; this in turn reduces the life of the mine. ***[Schedule 1, item 5, subsection 40-110(3A)]***

Application and transitional provisions

1.27 The amendments made by Schedule 1 to this Bill apply to assessments for the income year in which 1 July 2001 occurred, and later income years. ***[Schedule 1, item 7]***

1.28 This retrospectivity is required because the 2003 amendments, which specifically listed mining rights in the table in subsection 40-95(7), were also retrospective to 1 July 2001. This will ensure that the policy intent — to more closely align the treatment of mining rights to that for other depreciating assets, is reflected in the law since the introduction of Division 40. This does not disadvantage taxpayers as the intent of the law has always been followed and this measure clarifies the law.

Consequential amendments

1.29 Subsection 40-95(8) establishes an upper limit on the effective life of an intangible depreciating asset. Intangible depreciating assets mentioned in the table in subsection 40-95(7) (which statutorily provides an effective life for certain intangible assets) and an indefeasible right to use a telecommunication cable system are excluded from subsection 40-95(8) as they are included in the table in subsection 40-95(7). As the new law will remove mining rights from this table, a specific reference to mining rights being excluded from subsection 40-95(8) will be inserted in that subsection in order to preserve their exclusion from that subsection. ***[Schedule 1, item 2, subsection 40-95(8)]***

Chapter 2
Taxation of boating activities

Outline of chapter

2.1 Schedule 2 to this Bill changes the taxation treatment of boating activities. These changes allow taxpayers who cannot demonstrate that they are carrying on a business using a boat to claim deductions for boating expenses up to the level of their boating income.

2.2 Deductions in excess of the boating income are carried forward to be deducted against assessable income from boating activities in later years.

2.3 These changes do not affect deductions for expenses in carrying on a boating business.

2.4 These changes apply for income years starting on or after Royal Assent.

Context of amendments

What is the current taxation treatment of boating activities?

2.5 The current law denies deductions related to income-earning activities associated with using or holding boats unless the taxpayer is carrying on a business of a specified type. For example, it does not allow a deduction where a taxpayer's ownership or use of a boat generates merely passive income. The current treatment is designed to ensure the tax system does not subsidise the private use of boats.

Why is the current law being changed?

2.6 The law is being changed to ensure that taxpayers are not unfairly treated by taxing their income from boating but denying them deductions for the related expenses, while maintaining restrictions on using the tax system to subsidise the private use of boats.

Summary of new law

2.7 The changes allow taxpayers who cannot demonstrate that they are carrying on specified types of boating businesses that involve the use or holding of boats, to claim deductions related to their income-earning boating activities.

2.8 However, they can only use those deductions to the extent that they have assessable income in that year from their boating activities. Any excess deductions are carried forward and deducted against income from their boating activities in future years.

Comparison of key features of new law and current law

New law	***Current law***
Taxpayers can deduct amounts related to using or holding boats up to the level of their boating income for that income year. Any excess deductions are carried forward to be deducted against future income from their boating activities. These changes do not affect deductions for expenses in carrying on specified types of boating businesses involving the use or holding of boats.	Taxpayers cannot deduct amounts related to using or holding boats unless they are carrying on specified types of boating businesses involving using or holding a boat.

Detailed explanation of new law

2.9 Deductions related to using or holding boats are capped at the level of income earned from boating activities. Any excess deductions are quarantined and deferred to later years. ***[Schedule 2, item 1, subsection 26-47(2)]***

2.10 Two exceptions to the general rule apply:

- amounts attributable to specified types of boating businesses are not quarantined ***[Schedule 2, item 1, subsection 26-47(3)]***; and
- amounts incurred in providing fringe benefits are not quarantined ***[Schedule 2, item 1, subsection 26-47(4)].***

2.11 The quarantined amount is modified for taxpayers who:

- have boating capital gains ***[Schedule 2, item 1, subsection 26-47(5)]***;
- have profits from a boating business in an income year (being one of the specified types of boating business) ***[Schedule 2, item 1, subsection 26-47(6)]***;
- derive exempt income ***[Schedule 2, item 1, subsection 26-47(8)]***; and
- become bankrupt ***[Schedule 2, item 1, subsection 26-47(9)].***

The quarantining rule for deductions from boating activities

2.12 A taxpayer earning income from using or holding boats may deduct expenditure relating to the activity up to the amount of assessable income derived. Taxpayers will be allowed to carry forward any excess deductions and deduct them against income generated from boating activities in future years. If income from the boating activities ceases for a year or number of years, the quarantined amount will be carried forward repeatedly and become deductible in the income year when assessable income is next earned from boating activities. ***[Schedule 2, item 1, subsection 26-47(2)]***

Example 2.1: Carrying forward and deducting a quarantined amount

Ian owns a boat which he leases to a charter operator. In Year 1, Ian has available $100,000 in deductions relating to his income-earning boating activities, including interest, depreciation, running costs and management fees. He earns only $40,000 income from leasing the boat. Therefore he can only deduct $40,000. The remaining $60,000 is carried forward to Year 2 (the quarantined amount).

In Year 2, Ian has $95,000 of boating deductions and no income from the boat. Provided the deductions are otherwise allowable, the quarantined amount will accumulate to $155,000 and be carried forward to Year 3. Ian cannot claim any of the $95,000 of boating deductions in Year 2.

In Year 3, Ian has $60,000 of boating deductions and $150,000 of income from the boat. The deductions from Year 3 *plus* the quarantined amount from Year 2 adds up to $215,000. Therefore, Ian can claim a deduction of $150,000 and carry forward $65,000 to Year 4.

2.13 This rule applies to expenses that a taxpayer can otherwise deduct. For example, it does not apply to boating entertainment expenses for which the income tax law would already deny a deduction.

Using or holding a boat

2.14 The quarantining rule applies to all expenses 'relating to using or holding boats' which a taxpayer could otherwise deduct. The rule is intended to quarantine deductions for expenses which the law previously denied; it does not change the scope of the current law. Subsection 26 50(1) of the *Income Tax Assessment Act 1997* (ITAA 1997) states that a taxpayer cannot deduct a loss or outgoing to the extent they incur it:

- to acquire ownership of a boat;
- to retain ownership of a boat;
- to acquire rights to use a boat;
- to retain rights to use a boat;
- to use, operate, maintain or repair a boat;
- in relation to any obligation associated with ownership of a boat; or
- in relation to any obligation associated with the taxpayer's rights to use a boat.

[Schedule 2, item 1, subsection 26-47(2)]

2.15 Advertising, signage and similar promotional expenditure that is otherwise deductible will generally not be affected by the quarantining rule (eg, if it is incurred in relation to promoting a non-boating business). This is because the expenditure is not in relation to using or holding a boat. However, advertising expenses would be quarantined where the taxpayer holds or uses a boat to earn assessable income from the holding or use of a boat. There is an exception where the taxpayer is carrying on a boating business of the specified type.

Example 2.2: Advertising by a boat owner

Phil, a plumber, paints the name of his plumbing business on the side of his private boat. He can deduct the cost of painting the advertisement because it is not an amount 'relating to using or holding the boat' and so is not affected by this measure. He cannot deduct his other boating expenses, such as those for depreciation or interest costs on the boat, because they are private expenses not incurred in gaining income and so not deductible in the first place.

Example 2.3: Advertising by a third party

An anti-perspirant company pays $200,000 to have its logo displayed on the spinnaker of a yacht in the Sydney to Hobart yacht race. This payment is strictly for advertising only, and not for any other benefits. For example, it does not entitle persons associated with the anti-perspirant company to any places on the boat during the race or otherwise.

The anti-perspirant company may deduct the $200,000 advertising expense. The quarantining rule does not apply to the expense as it is not for using or holding a boat.

Had the yacht's owner incurred advertising expenditure in winning the $200,000 contract with the anti-perspirant company, then that expenditure would be quarantined together with other costs from holding or using the boat (assuming the owner was not carrying on a boating business).

Example 2.4: An advertising expense that is not deductible

Jonathan, a retiree, hires out his fishing boat to tourists from time to time. He pays to have 'For Hire' painted on the side of his boat. The quarantining rule applies to this expense because it is related to Jonathan's use of the boat — hiring it out to tourists.

Apportionment of deductions that partly relate to using or holding a boat

2.16 Outgoings are only quarantined to the extent they relate to using or holding boats.

Example 2.5: Loan expenses

Michael borrows $500,000 from his bank. He uses $250,000 to finance the purchase of a new boat which he hires out during the income year. He uses the remaining $250,000 to invest in shares. He pays $50,000 in interest to the bank in the income year. He earns $2,000 in charter fees from the boat.

He apportions the interest expense 50/50 between the boat and the shares. The half relating to the shares — $25,000 of interest expense — is deductible. Of the half relating to the boat he can deduct $2,000 and carry forward a quarantined amount of $23,000 which he can deduct against boating income in future years.

Exceptions to the quarantining rule

2.17 Two exceptions to the general rule are that amounts are not quarantined if they are:

- attributable to certain specified boating business activities ***[Schedule 2, item 1, subsection 26-47(3)]***; or
- incurred in providing fringe benefits ***[Schedule 2, item 1, subsection 26-47(4)].***

The exception for business use

2.18 A specific exception to the quarantining rule applies if the taxpayer is using or holding the boat in carrying on a specified type of boating business. These amendments specify the particular business uses of a boat that qualify for the exception. These uses are the same as those in current subsection 26-50(5) of the ITAA 1997 and, broadly, require the boat to be at the centre of the business activities (eg, it is trading stock or used to transport goods or passengers). ***[Schedule 2, item 1, subsection 26-47(3)]***

2.19 If the taxpayer is carrying on such a boating business, the deductions attributable to those activities can be offset against *any* assessable income of the taxpayer, in the same way that any other business deductions can be. However, where the taxpayer has deductions in respect of the use or holding of a boat that were not related to one of the specified types of boating businesses, the deductions would be subject to the quarantining rule.

The exception for fringe benefits

2.20 An exception to the quarantining rule applies to expenditure a taxpayer incurs in providing a fringe benefit. The effect is that expenditure in providing a fringe benefit (eg, in providing an employee with a boat as part of a salary package) is deductible regardless of the level of the employer's boating income and so never forms part of an employer's quarantined amount. This is consistent with the general treatment under the income tax law of expenses in providing fringe benefits and continues the exception provided by current subsection 26-50(8). ***[Schedule 2, item 1, subsection 26-47(4)]***

Example 2.6: A taxpayer provides a fringe benefit

Fiona provides her employee Steve with the use of a boat as part of his salary package. Providing the boat costs Fiona $20,000 per year. As the boat is a fringe benefit, Fiona can deduct the $20,000 as an employee expense — it is not quarantined.

Modifications to the quarantining rule

2.21 The amount to be carried forward is modified for taxpayers who:

- have boating capital gains ***[Schedule 2, item 1, subsection 26-47(5)]***;
- have profits from a specified type of boating business in an income year ***[Schedule 2, item 1, subsection 26-47(6)]***;
- derive exempt income ***[Schedule 2, item 1, subsection 26-47(8)]***; or
- become bankrupt ***[Schedule 2, item 1, subsection 26-47(9)].***

Application of the general rule when a taxpayer has boating capital gains

2.22 The quarantining rule is modified for taxpayers who have capital gains from their boating activities. A quarantined amount that is to be carried forward to a future income year is first used to reduce a boating capital gain a taxpayer has for the year. In essence capital gains from boats are treated as if they were income from boating activities. ***[Schedule 2, items 1 and 4, subsection 26-47(5) and section 118-80]***

Example 2.7: Boating capital gains

Greg owns a boat which he leases to a charter operator. In one year, Greg has $50,000 in income tax deductions relating to the boat. He has no boating income but has a $5,000 boating capital gain. The quarantined amount carried forward to future years is $45,000 ($50,000 *reduced* by the boating capital gain of $5,000). The capital gain is reduced to nil and is not included in working out Greg's assessable income.

2.23 The cost base and the reduced cost base of an asset have to be worked out in order to calculate a capital gain or loss on a capital asset. Deductible expenditure is usually excluded in working out the cost base or the reduced cost base of an asset. Amounts that are quarantined are not included in an asset's cost base or reduced cost base. This treats the amounts as being deductible, even though the deduction is deferred and,

so, ensures that the income tax system does not recognise the amount twice. ***[Schedule 2, items 2 and 3, subsections 110-38(5) and 110-55(9E)]***

Deduction for boat business profits

2.24 The quarantining rule for deferring a quarantined amount is also modified for a taxpayer who has profits from a specified type of boating business in an income year. After it has been reduced by any boating capital gains, a taxpayer can deduct any remaining quarantined amount up to the amount of that profit, and reduce the remaining quarantined amount accordingly. Current year boating deductions are applied first before deducting the quarantined amount. ***[Schedule 2, item 1, subsections 26-47(6) and (7)]***

Example 2.8: Boat business profits

> Adrian owns a boat which he hires out occasionally. In one year, Adrian has $50,000 in deductions relating to the boat and boating income of $80,000, leaving a boating profit of $30,000. Adrian also has a carried forward quarantined amount of $70,000 from the previous year. Adrian can deduct $30,000 of the quarantined amount against his boating income, in addition to the $50,000 in deductions for the current year. The quarantined amount carried forward to the following year is $40,000 ($70,000 *reduced* by the $30,000 used up).

Application of the quarantining rule when a taxpayer has exempt income

2.25 The quarantining rule for deferring a quarantined amount is further modified for a taxpayer who derives exempt income. After it has been reduced by any boating capital gains or boating business profits, any remaining quarantined amount that is to be carried forward to a future income year is reduced by the amount of any exempt income derived in the current year that has not already been offset against carry-forward amounts from Division 35 (non-commercial losses) or Division 36 (general tax losses) of the ITAA 1997. ***[Schedule 2, item 1, subsection 26-47(8)]***

Example 2.9: A taxpayer deriving exempt income

Gaurav owns a boat which he hires out occasionally. In a year, Gaurav has $50,000 in deductions relating to the boat and boating income of $10,000. He also derives $5,000 of exempt income. The quarantined amount carried forward to future years is $35,000 ($50,000 *reduced* by the sum of the boating income ($10,000) and the exempt income ($5,000)).

Exception when a taxpayer becomes bankrupt

2.26 A quarantined amount arising before bankruptcy cannot be deducted afterwards. This includes any quarantined amounts generated in the year that the taxpayer is declared bankrupt. This exception follows the model in Divisions 35 (about deferral of losses from non-commercial business activities) and 36 (about deducting losses generally under the tax law) of the ITAA 1997. ***[Schedule 2, item 1, subsections 26-47(9) and (10)]***

Example 2.10: A taxpayer becomes bankrupt

Nick hires out his boat using a charter boat operator. In Year 1, Nick has a $50,000 quarantined amount to be carried forward to Year 2.

In Year 2, Nick has boating expenses of $20,000 and is also declared bankrupt. Therefore, in Year 2 Nick cannot deduct the quarantined amount brought forward. Nick can still deduct the expenses he incurred in Year 2 but any excess deductions cannot be used in Year 2 or deferred to later years.

Grouping of boating activities

2.27 A taxpayer may hold and operate several boats that are subject to the quarantining rules. In such cases, the taxpayer can claim the total deductions relating to all the boats up to the amount of the total income from all the boats. In effect, taxpayers can offset deductions relating to one boat against income from another boat. ***[Schedule 2, item 1, subsection 26-47(2)]***

Example 2.11: Grouping boating activities

Thomas holds two boats — Nuclear Fishin’ and Knot So Fast — which are offered for hire through two different charter operators. He is not carrying on a boating business. Thomas can offset the otherwise deductible expenses he incurs in relation to Nuclear Fishin’ against the income from Knot So Fast, and vice versa. The excess of all his boating deductions over his boating income can be deducted against boating income in a future year even if he no longer owns the same boats that generated those deductions.

Application and transitional provisions

2.28 These proposed amendments apply to the first income year starting on or after the day on which this Bill receives Royal Assent, and to later income years. ***[Schedule 2, item 18]***

Consequential amendments

2.29 Section 12-5 of the ITAA 1997 is a non-operative list of provisions about deductions. The item for boats in this section currently refers to section 26-50. With the changes, this is no longer accurate as the deduction provisions for boats are in a different section. Therefore, a consequential amendment changes the reference to the correct section. ***[Schedule 2, item 6, item in the table relating to boats in section 12-5]***

2.30 Sections 26-50 and 40-25 specify the tax and depreciation treatment of expenses relating to boats and leisure facilities. Consequential amendments to these sections reflect the fact that they will now only deal with leisure facilities. ***[Schedule 2, items 7 to 17, paragraphs 25-50(1)(a) to (g) and 26-50(7)(a), subsections 25-50(1) and (5) to (7)]***

2.31 A consequential amendment to paragraph 69-5(3)(e) of the *A New Tax System (Goods and Services Tax) Act 1999* removes the reference to 'boat'. Section 69-5 denies input tax credits for those expenses that are non-deductible because of listed provisions in the ITAA 1997 (including section 26-50). Removing the words 'or boat' reflects the fact that section 26-50 no longer deals with boating deductions. As a result, entities will be entitled to input tax credits for creditable acquisitions or creditable importations of boats to the extent they acquire them in carrying on their enterprises. ***[Schedule 2, item 5, paragraph 69-5(3)(e) of the A New Tax System (Goods and Services Tax) Act 1999]***

Chapter 3
Certain expenditure on research and development activities

Outline of chapter

3.1 Schedule 3 to this Bill amends the provisions of the *Income Tax Assessment Act 1936* (ITAA 1936) relating to expenditure on research and development (R&D). These amendments clarify and make 10 technical amendments to the provisions for the premium incremental concession and the refundable R&D tax offset.

Context of amendments

3.2 The R&D provisions of the ITAA 1936 allow a tax concession for certain expenditure on R&D.

3.3 Two elements of the R&D tax concession, that have applied from the income year starting after 30 June 2001, are the refundable R&D tax offset and the premium incremental concession.

3.4 On 9 May 2006, as part of the 2006-07 Budget, the Government announced it would improve the operation of the R&D provisions by amending taxation legislation to clarify the law, remove unintended consequences and ensure that the law reflects the original policy intent in relation to the R&D tax offset and the premium incremental concession.

Summary of new law

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).

Comparison of key features of new law and current law

New law	***Current law***
Companies will be able to object to written notices from the Commissioner of Taxation (Commissioner) if they are dissatisfied with the amount allowed under the R&D tax offset.	The current law states that a company can object to an assessment when there is an amount of taxation payable. Companies in a loss situation, however, may not have a year end tax assessment. As an income tax assessment is the trigger for the availability of taxpayer objection and appeal rights those companies who are dissatisfied with decisions by the Commissioner relating to the R&D tax offset are unable to object.

New law	***Current law***
Companies will be able to choose the R&D tax offset in writing to the Commissioner within the normal time for amendment of income tax assessments.	Companies must choose the R&D tax offset in the year in which they are entitled to the R&D tax offset. There is no provision for a company to choose the R&D tax offset by amending their original return.
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 their aggregate expenditure is less than $20,000.	The R&D tax concession has a general exception to the $20,000 minimum spend rule for contracted expenditure to a Registered Research Agency on behalf of a company. This exception does not apply if the R&D tax offset is claimed.
The reference to ‘taxpayers’ will be replaced with ‘persons’.	The R&D expenditure threshold for offset eligibility applies to all R&D expenditure undertaken by all ‘taxpayers’ in a group. This may not cover all companies in a group.
Section 73H will now correctly refer to section 73L.	Section 73H of the ITAA 1936 incorrectly refers to section 72L.
The premium incremental concession will be distributed amongst all companies that have increased their R&D expenditure over the average of their past three year’s expenditure.	A group may have increased its R&D expenditure over its three year average and be eligible for the premium incremental concession yet it cannot get the premium incremental concession because distribution rules do not allocate a premium amount to any of the companies in the group.
The R&D provisions will refer to the company’s group membership period for eligibility for the premium incremental concession.	A group of companies is eligible for the premium incremental concession if one company in the group is eligible. A group may become eligible for the premium incremental concession based on the expenditure of a new company entering the group. As the new company does not take its expenditure history to the new group it should also not automatically make the new group eligible for the premium incremental concession which is based on expenditure not incurred as part of the group. This should only occur in circumstances where a viable business transfer has occurred that assigns the expenditure history of the new company to the new group.

New law	*Current law*
Reference to a 'start grant' is replaced with reference to the Commercial Ready program.	Eligibility to the premium incremental concession can be established based on a company receiving a 'start grant'. The R&D Start program to which this refers has been replaced with the Commercial Ready program.
Where the calculation of an incremental amount is negative it will be taken to be zero.	Amounts relevant to the 175 per cent premium incremental concession may be calculated to have a negative result for that income year. As this is a tax concession there should not be a negative consequence resulting from its calculation.
Section 12-5 of the ITAA 1997 will now refer to the premium incremental concession.	Section 12-5 of the ITAA 1997 is a reference section for all deductions in the income tax law. It currently does not refer to the premium incremental concession.

Detailed explanation of new law

3.6 The 10 technical amendments in this Schedule seek to ensure that the R&D tax offset and the premium incremental concession reflect the original policy intent. They clarify the law in situations where the intended outcome did not occur.

3.7 Companies currently are unable to object to decisions relating to the R&D tax offset due to subsection 175A(2) of the ITAA 1936 stating that a taxpayer with no taxable income cannot object against an assessment unless to increase their tax liability. This Schedule creates a new right of objection for claimants of the R&D tax offset against a written notice from the Commissioner specifying the amount of a R&D tax offset allowable to the company. This objection right will be consistent with other objection rights, such as in the circumstances of the R&D tax concession, according to Part IVC of the *Taxation Administration Act 1953*. Companies will be allowed between two and four years to lodge an objection with the Commissioner depending on the complexity of their taxation affairs. The timeframe allowed is aligned with the same timeframe that the Commissioner has to amend the assessment of the taxpayer. ***[Schedule 3, items 3 and 22]***

3.8 Companies are currently required to choose the R&D tax offset in the income year that expenditure is incurred. Companies who have failed to choose the R&D tax offset will be now be able to claim the R&D tax offset by writing to the Commissioner within the normal timeframe

that the Commissioner could amend that company's assessment for the relevant income year. ***[Schedule 3, item 2]***

3.9 Under the R&D tax concession there is a general exception to the minimum expenditure threshold of $20,000 if a company incurs contracted expenditure to a Registered Research Agency. This exception will be extended where the company wishes to claim the R&D tax offset for the amount of contracted expenditure. ***[Schedule 3, item 5]***

3.10 The R&D tax offset provisions refer to 'taxpayers' which is too narrow to cover certain companies that the original policy intent was to encompass. References to 'taxpayers' will be replaced with 'persons' that will cover all companies in a group. ***[Schedule 3, items 7 and 8]***

3.11 There is an incorrect section reference (section 73H of the ITAA 1936) in the R&D provisions which will be corrected. ***[Schedule 3, item 1]***

3.12 Under the 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. This situation arises as a group of companies may have a collective expenditure greater than the rolling three year average of the group and hence the group is entitled to an amount of the premium incremental concession. However, it is possible that no company in the group will have increased their expenditure over the previous year's expenditure. In these circumstances, there will be no distribution of the premium amount that the group would otherwise be eligible for. This will be remedied by calculating the distribution of a premium amount to companies in a group based on the companies' expenditure over the average of the previous three year's expenditure. ***[Schedule 3, item 19]***

3.13 A group of companies is eligible for the premium incremental concession when any group member can establish eligibility for the premium incremental concession. Currently, a new company entering a group can make the group automatically eligible for the premium incremental concession if it could establish eligibility by reference to R&D expenditure incurred prior to joining the group. As the new company entering the group does not take its expenditure history to the new group it should also not automatically make the new group eligible for the premium incremental concession based on expenditure not incurred as a member of the group. The new law will ensure that if a company is unable to take its expenditure history to a new group, which is allowed by viable business transfers, it will not be able to establish eligibility for the group to the premium incremental concession based on expenditure incurred when the company was not a member of the group. ***[Schedule 3, items 12 and 13]***

3.14 The R&D Start program which can be used to establish eligibility for the premium incremental concession no longer exists. This program was abolished and replaced with the Commercial Ready program that commenced on 6 May 2004. Companies will now be able to establish eligibility for the premium incremental concession based on a payment under the Commercial Ready program. ***[Schedule 3, items 10 and 15]***

3.15 The R&D provisions specify a method for calculating the incremental amount a group of companies or a single company may deduct. This calculation may lead to a negative incremental amount where the aggregate R&D expenditure of the company or group of companies is less than the average of the previous three years of R&D expenditure. As the premium incremental concession is intended to provide a benefit to eligible companies, in these circumstances negative amounts will now be taken to be zero. ***[Schedule 3, item 17]***

3.16 Section 12-5 of the ITAA 1997 provides a reference list of deductions in the tax law. This list will now include the premium incremental concession. ***[Schedule 3, item 21]***

Application and transitional provisions

3.17 The amendment to create a new objection right for taxpayers dissatisfied with the amount allowable under the R&D tax offset applies to years of income commencing on or after 1 July 2001, which is the date of commencement for the R&D tax offset. The amendment creating a timeframe of two to four years applies from Royal Assent. ***[Schedule 3, item 4]***

3.18 The amendment to allow companies to choose the R&D tax offset by writing to the Commissioner within the normal time for amendment applies from the date of Royal Assent.

3.19 The extension of the general exception for contracted expenditure of the minimum expenditure threshold applies from income years commencing on or after the day on which this amendment receives Royal Assent. ***[Schedule 3, item 6]***

3.20 The reference to persons rather than taxpayers in the R&D tax offset provisions will apply from the first year of income commencing after 9 May 2006 and later years. ***[Schedule 3, item 9]***

3.21 The correction of the section reference will apply from the date of Royal Assent.

3.22 The amendment relating to the distribution of the incremental amount applies from the year of income following the year of income in which these amendments receive Royal Assent and later years. ***[Schedule 3, item 20]***

3.23 The amendment that refers the eligibility for the premium incremental concession to a company's group membership applies from the year of income following the year of income in which this amendment receives Royal Assent and later years. ***[Schedule 3, item 14]***

3.24 The reference to the Commercial Ready program in place of the start grant in the premium incremental concession provision will apply from 6 May 2004 which is the date of the Commercial Ready program's announcement. ***[Schedule 3, items 11 and 16]***

3.25 The amendment of the calculation for the incremental amount to be taken as zero applies to years of income commencing on or after 1 July 2001. ***[Schedule 3, item 18]***

3.26 The reference to the premium incremental concession in the reference list of deductions in the income tax law applies from Royal Assent.

Chapter 4
Donation of listed shares to deductible gift recipients

Outline of chapter

4.1 Schedule 4 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to allow a tax deduction for donations of small parcels of shares in listed public companies to eligible deductible gift recipients (DGRs).

Context of amendments

4.2 The income tax law encourages philanthropy through a range of taxation measures. Donations of money or property to DGRs valued at $2 or more are tax deductible.

4.3 Currently, gifts of property to DGRs — which can include shares — are tax deductible if the property is purchased during the 12 months before making the gift, or valued by the Commissioner of Taxation at more than $5,000.

4.4 Gifts of property, including shares, acquired at least 12 months before making the donation, and valued at $5,000 or less, are currently not tax deductible.

Summary of new law

4.5 These amendments allow taxpayers a tax deduction where they gift to a DGR, shares in a listed public company that were acquired at least 12 months before the donation, and have a market value of $5,000 or less. The allowable deduction is the market value of the shares on the day the donor makes the gift.

4.6 This measure was announced in the 2006-07 Budget, and applies in relation to gifts and contributions made in an income year commencing on or after Royal Assent.

Comparison of key features of new law and current law

New law	***Current law***
Gifts to DGRs of shares acquired in an Australian listed public company at least 12 months before making the gift and having a market value of $5,000 or less, are tax deductible.	Gifts to DGRs of shares acquired in an Australian listed public company at least 12 months before making the gift and having a market value of $5,000 or less, are not tax deductible.

Detailed explanation of new law

4.7 To further enhance the flexibility of the current tax measures for donations to DGRs, this measure allows a tax deduction for gifts to DGRs of small parcels of shares in listed public companies, which could include a gift of a single share provided the value is $2 or more.

4.8 Taxpayers gifting shares can deduct the market value of the shares on the day they make the gift, provided that the shares:

- were acquired at least 12 months before making the gift;
- have a market value of $5,000 or less;
- were acquired in a listed public company; and
- are listed for quotation on the official list of an Australian stock exchange.

[Schedule 4, items 1 to 6, subsection 30-15(2), items 1 and 2 in the table]

Shares acquired

4.9 Shares ‘acquired’ include shares that come into the donor’s possession through a variety of means, for example, shares that have been purchased, inherited, won, received as a gift or received as a bonus.

Meaning of share

4.10 A ‘share’ in a company refers to a share in the capital of the company. Securities that are not shares, including derivatives of shares, are outside this measure. ***[Schedule 4, items 1, 4 and 7, subsection 30-15(2), items 1, 2 and 7 in the table]***

Capital gains tax

4.11 The disposal of shares under this measure is a capital gains tax (CGT) event, and taxpayers who choose to donate shares are still subject to CGT.

Example 4.1

George purchased 100 shares in Lion Resources two years ago at $14 a share. Lion Resources is a listed public company on an Australian stock exchange.

George decides to gift the shares to Fun Run, a DGR. George signs and submits a share ownership transfer document to donate the 100 shares to Fun Run.

The market value of the shares at the time George gifted the shares was $12 per share, bringing the total market value of the parcel to $1,200. Therefore, George can claim a tax deduction of $1,200.

CGT treatment

As the gifting of shares is a CGT event, George has also incurred a capital loss. Assuming a reduced cost base of $14 a share, the capital loss will be the difference between the reduced cost base of the shares ($1,400) and the capital proceeds, which is the market value of the shares ($1,200). In this case, George has a capital loss of $200. It follows that George would make a capital gain if the market value of the shares was greater than the cost base.

Suspended shares

4.12 Shares that are suspended from trading (other than a mere trading halt) are not listed for quotation, and are therefore outside this measure. ***[Schedule 4, items 1, 4 and 7, subsection 30-15(2), items 1, 2 and 7 in the table]***

Donations of shares in more than one company

4.13 Donations of shares that are in different companies, but gifted at the same time, are separate donations.

Example 4.2

Mark wishes to gift $3,000 of shares in Red Ltd and $4,000 of shares in Blue Ltd, both listed public companies, to a DGR. Both of these parcels of shares were purchased more than 12 months ago. Mark signs and submits two share ownership transfer forms.

Although their combined value exceeds $5,000, Mark can still deduct the gifts of shares as they are treated as separate gifts each valued at $5,000 or less.

Donations of shares purchased in the last 12 months

4.14 Where a donor wishes to gift a parcel of shares that includes both shares acquired more than 12 months ago and shares purchased in the last 12 months, the donor can claim a deduction under this amendment and under existing provisions respectively. ***[Schedule 4, items 1, 4 and 7, subsection 30-15(2), items 1, 2 and 7 in the table]***

4.15 A deduction for shares acquired more than 12 months ago is available as per the examples above, whereas a deduction for property purchased in the 12 months before making the gift is available under subsection 30-15(2), item 1 in the table. In the case of property purchased in the last 12 months, which may include shares recently purchased as part of a dividend reinvestment scheme, a deduction can be claimed for the lesser of the market value of the shares on the day the gift was made, and the amount paid for the shares.

Example 4.3

Michelle currently holds shares in DRP Ltd, a listed public company. Michelle entered into a dividend reinvestment scheme with DRP Ltd two years ago. As part of this scheme, DRP Ltd recently paid a dividend to Michelle which purchased $480 in shares in the company.

Michelle gifts all her shares in DRP Ltd to a DGR within 12 months of receiving the dividend. At the time of the gifting the shares held for more than 12 months were valued at $4,000, while the shares purchased with the dividend were valued at $500.

Under this amendment, Michelle can claim a tax deduction of $4,000 in respect of the shares acquired more than 12 months before making the gift.

Michelle can also claim a deduction of $480 for the shares purchased in the last 12 months under subsection 30-15(2), item 1 in the table, noting that the $480 purchase price is less than the $500 market value at the time of gifting.

The company must be listed at the time the shares are gifted

4.16 The amendments apply only to shares in a public company that were listed for quotation in the official list of a stock exchange when the shares were donated. The stock exchange must be listed under the heading 'Australia' in regulations made for the purposes of the definition of 'approved stock exchange' (see Schedule 12 to the *Income Tax Regulations 1936*). ***[Schedule 4, items 1, 4 and 7, subsection 30-15(2), items 1, 2 and 7 in the table]***

Example 4.4

Eva purchased shares in a private company, for $400 two years ago. Eva will not be able to receive a tax deduction for any gift of those shares as they are not in a listed public company.

Contributions of shares where a right to attend a fundraising event is received in return

4.17 These amendments also allow a deduction for contributions of shares by an individual donor made in return for a right, permitting the donor or another individual, to attend, or participate in a particular fundraising event in Australia.

4.18 Consistent with the criteria for gifted shares, the contributed shares must be:

- in a listed public company and listed for quotation in the official list of a stock exchange under the heading 'Australia' in regulations made for the purposes of the definition of an 'approved stock exchange';
- acquired at least 12 months before making the contribution; and
- have a market value on the day the donor makes the contribution of $5,000 or less, but more than $150.

Furthermore, the GST inclusive market value of the fundraising event must not exceed 20 per cent of the value of the shares and $150, whichever is the less. ***[Schedule 4, items 7 and 9, subsection 30-15(2), item 7 in the table]***

Note: the thresholds surrounding deductions where the right to attend a fundraising event is received in return are amended by Schedule 6 to this Bill. Chapter 6 refers to the new thresholds.

4.19 If these criteria are satisfied, the donor can deduct the market value of the shares on the day they make the contribution, *reduced* by the goods and services tax (GST) inclusive market value of the right to attend the fundraising event. ***[Schedule 4, item 8, subsection 30-15(2), item 7 in the table]***

Example 4.5

Martin contributes a parcel of shares to a DGR that were acquired 18 months ago in a public listed company. In return Martin is given a ticket to attend the DGRs annual gala dinner fundraising event.

At the time Martin contributed the shares, they had a market value of $1,000. The GST inclusive market value of the right to attend the fundraising event is $100.

Martin can claim a tax deduction for $900, which is the market value of the shares ($1,000) *less* the GST inclusive market value of the right to attend the fundraising event ($100).

Application and transitional provisions

4.20 This measure applies in an income year commencing on or after the date of Royal Assent. ***[Schedule 4, item 10]***

Chapter 5
Deductible gift recipients

Outline of chapter

5.1 Schedule 5 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to update the list of deductible gift recipients (DGRs) to include two new entities and to extend the time period of DGR status for one entity. This Schedule also reflects a name change of one entity listed as a DGR under section 30-65 of the ITAA 1997.

Context of amendments

5.2 The income tax law allows taxpayers who make a gift of $2 or more to DGRs to claim income tax deductions. To be a DGR, an organisation must fall within a category of organisations set out in Division 30 of the ITAA 1997, or be listed by name under that Division.

5.3 DGR status assists relevant funds and organisations to attract public support for their activities.

Summary of new law

5.4 These amendments add two organisations to the list of specifically listed DGRs and extend the time period for which deductions are allowed for gifts to The Finding Sydney Foundation. Gifts of $2 or more, made to these entities within each entity's eligible time period, are tax deductible.

5.5 The amendments also update the ITAA 1997 to reflect a name change of one entity specifically listed as a DGR.

Detailed explanation of new law

5.6 Schedule 5 lists the organisations in Table 5.1 as DGRs. ***[Schedule 5, items 3 to 6]***

Table 5.1

Name of fund	***Date of effect***	***Special conditions***
American Australian Association Limited	14 November 2006	
Bunbury Diocese Cathedral Rebuilding Fund	19 December 2006	The gift must be made before 19 December 2008.

5.7 The American Australian Association Limited was established to promote friendship, cooperation and understanding between Australia and the United States of America. The American Australian Association Limited intends to establish a United States Studies Centre at an Australian university, and facilitate education scholarships and programmes, conferences and seminars, cultural events and other activities to further the American Australian Association Limited's objectives. ***[Schedule 5, items 3 and 5]***

5.8 St Patrick's Cathedral in Bunbury was destroyed by a tornado on 16 May 2005. St Patrick's Cathedral is a significant landmark and spiritual centre for a large number of people in Western Australia's South West, Great Southern, and South Coastal regions. DGR specific listing has been provided to the Bunbury Diocese Cathedral Rebuilding Fund to assist in rebuilding the cathedral. ***[Schedule 5, items 4 and 6]***

Extending periods for which gifts are deductible

5.9 Schedule 5 also extends the period for which deductions are allowed for gifts to the organisation listed in Table 5.2. ***[Schedule 5, item 1]***

Table 5.2

Name of fund	***New special conditions***	***Current special conditions***
The Finding Sydney Foundation	The gift must be made after 26 August 2004 and before 28 August 2007.	The gift must be made after 26 August 2004 and before 27 August 2006.

5.10 The Finding Sydney Foundation was established to search for the HMAS Sydney and the German auxiliary cruiser HSK Kormoran, that disappeared off the Western Australian coast on 19 November 1941, and to establish a virtual memorial to the sailors, the vessels, and the engagement. The loss of the HMAS Sydney with its crew of 645 remains one of Australia's greatest wartime mysteries. ***[Schedule 5, item 1]***

Reflecting a name change of a specifically listed DGR

5.11 Currently, Indigenous Community Volunteers Limited is listed under its previous name, Voluntary Service to Indigenous Communities Foundation. This Schedule updates the ITAA 1997 to reflect its name change to Indigenous Community Volunteers Limited. ***[Schedule 5, items 2, 7 and 8]***

5.12 Indigenous Community Volunteers Limited offers support to Indigenous communities to pursue their community development goals in their own way, by matching the skills and interests of volunteers with specific projects and skill needs identified by Indigenous communities and organisations. ***[Schedule 5, items 2, 7 and 8]***

Application and transitional provisions

5.13 The amendments to list the organisations in Table 5.1 apply from the dates of effect shown in those tables. ***[Schedule 5, items 1 and 3 to 6]***

Chapter 6
Deductions for contributions relating to fund-raising events

Outline of chapter

6.1 Schedule 6 to this Bill extends eligibility for tax deductions for contributions to deductible gift recipients (DGRs), where an associated minor benefit is received for an eligible fund-raising event. The deduction is available where the value of the contribution is more than $150 (the current threshold is more than $250), and the minor benefit received in return is no more than $150 (currently $100) and 20 per cent (currently 10 per cent) of the value of the contribution, whichever is the less.

Context of amendments

6.2 Prior to 1 July 2004, contributions made to DGRs were not deductible if a benefit was received by the contributor in return for their contribution.

6.3 From 1 July 2004, to increase flexibility for fund-raising, the 'minor benefits measure' allows deductions for contributions of certain cash and property to DGRs for eligible fund-raising events, where a minor benefit is received in return, so long as the value of the contribution is more than $250, and the minor benefit received in return is no more than $100 and 10 per cent of the value of the contribution, whichever is the less. Eligible fund-raising events are one-off fund-raising events conducted in Australia. The deduction is limited to that part of the contribution that is in excess of the minor benefit.

6.4 A review of the suitability of the thresholds of the minor benefits measure was undertaken in consultation with the Prime Minister's Community Business Partnership, to examine whether the thresholds should be extended to provide broader accessibility of the tax concession for fund-raising across the community.

Summary of new law

6.5 The amendments to the minor benefits measure allow individuals to deduct contributions to DGRs if:

- the value of the contribution is more than $150; and
- the minor benefit received in return is no more than $150 and no more than 20 per cent of the value of the contribution, whichever is the less.

6. 6 These amendments apply to contributions made on or after 1 January 2007.

Comparison of key features of new law and current law

New law	*Current law*
A deduction is allowed for contributions to DGRs for a fund-raising event, where the value of the contribution is more than $150, and the minor benefit received in return does not exceed the lesser of: 20 per cent of the value of the contribution, and $150.	A deduction is allowed for contributions to DGRs for a fund-raising event, where the value of the contribution is more than $250, and the minor benefit received in return does not exceed the lesser of: 10 per cent of the value of the contribution, and $100.

Detailed explanation of new law

6.7 From 1 July 2004, individuals can deduct contributions of certain cash and property to DGRs, where a minor benefit is received in return, so long as the value of the contribution is more than $250, and the minor benefit received in return is no more than $100 and 10 per cent of the value of the contribution, whichever is the less.

6.8 The amendments extend the current thresholds to provide DGRs with greater flexibility for their fund-raising activities and allow an individual to receive a deduction for contributions to DGRs of cash or property, where:

- the value of the contribution is more than $150; and
- the minor benefit received by the contributor in return, is no more than $150 and no more than 20 per cent of the value of the contribution, whichever is the less.

[Schedule 6, items 1 to 9, subsection 30-15(2), items 7 and 8 in the table]

Example 6.1: Fund-raising event

Anthony pays $260 to attend a charity golf day, hosted by a DGR. The market value of an 18-hole golf game is $50. As the market value of the golf game is less than $150 and less than 20 per cent of the value of his contribution ($260), Anthony can deduct $210 ($260 *less* $50).

Without the amendments to the thresholds, Anthony would not be entitled to a deduction as the market value of the minor benefit, the golf game ($50), is more than 10 per cent of the value of his contribution ($260 × 10 per cent = $26).

Example 6.2: Fund-raising auction

Kate successfully bids $2,000 for a T-shirt at a DGR fund-raising event auction. The T-shirt has a market value of $120. As the market value of the T-shirt is less than $150 and less than 20 per cent of the value of her contribution ($2,000), Kate can deduct $1,880 ($2,000 *less* $120).

Without the amendments to the thresholds, Kate would not be entitled to a deduction as the market value of the minor benefit, the T-shirt ($120), is more than $100.

6.9 All other requirements within the existing law relating to deductions for contributions for fund-raising events, are unchanged.

Application and transitional provisions

6.10 These amendments apply to contributions made on or after 1 January 2007. ***[Schedule 6, item 10]***

Chapter 7
Technical amendments and corrections

Outline of chapter

7.1 Schedule 7 to this Bill corrects a defect in the definitions of 'exempt entity' in the *Income Tax Assessment Act 1997* (ITAA 1997) and 'excepted trust' in the *Income Tax Assessment Act 1936* (ITAA 1936).

Context of amendments

7.2 The income tax law defines ***exempt entity*** to be an entity whose income is exempted by Division 50 of the ITAA 1997 or by another Commonwealth (non-income tax) law. Some Commonwealth, state and territory bodies are exempted otherwise than because of Division 50 or another Commonwealth law, so are not included within the definition of exempt entity.

7.3 This causes problems with some provisions that refer to exempt entities. One example is the provision recently added to the income tax law to exempt from tax those funds established solely to provide money to certain entities that are themselves exempt entities. Such a fund that provides money to a Commonwealth, state or territory body (eg, a state library or the National Portrait Gallery) that is exempt from income tax but not an exempt entity within the definition would lose its own exempt status.

7.4 A similar problem arises in Schedule 2F to the ITAA 1936, which requires trusts to satisfy particular tests before they can access their tax losses. It does not impose these requirements on 'excepted trusts'. 'Excepted trusts' include those where all the capital is beneficially owned by entities exempt under Division 50 of the ITAA 1997. If a trust's beneficiaries include an exempt state or territory body, the trust might not be an excepted trust and would have to satisfy the relevant tests before it could access its losses.

Summary of new law

7.5 Schedule 7 changes the definition of exempt entity in the ITAA 1997 so that it includes any entity if all of its income is exempted by any Commonwealth legislation or if it is an untaxable Commonwealth entity. It also changes the definition of excepted trust in Schedule 2F to the ITAA 1936, so that it requires all of its income and capital to be owned by exempt entities.

Comparison of key features of new law and current law

New law	*Current law*
'Exempt entity' includes all entities whose income is exempt under any Commonwealth law and all untaxable Commonwealth entities.	'Exempt entity' does not include all state and territory bodies that are exempt under Division 1AB of Part III of the ITAA 1936 or Commonwealth bodies that are not liable to taxation.
'Excepted trust' includes any trust if all the interests in it are held by exempt entities.	'Excepted trust' in Schedule 2F to the ITAA 1936 does not include all trusts that have interests held by state and territory bodies that are exempt under Division 1AB of Part III of the ITAA 1936.

Detailed explanation of new law

The definition of exempt entity and excepted trust

7.6 The income tax law defines exempt entity in a way that does not include all entities whose income is exempt from tax. The definition includes entities that are exempt under Division 50 of the ITAA 1997 but does not include state and territory bodies whose income is only exempt under Division 1AB of Part III of the ITAA 1936. Nor does it include Commonwealth bodies that are not liable to taxation. This result was not intended.

7.7 An example of a problem this causes occurs for some public ancillary funds and prescribed private funds. In 2005, these funds were made exempt if they distributed all their money to exempt entities. These funds would lose that income tax exemption if they distributed money to a state or territory body (eg, a state library) that is exempted under Division 1AB but not under Division 50 or to a Commonwealth body

(eg, the National Portrait Gallery) that is not liable to taxation but is not exempted under any law.

7.8 A similar problem occurs in the trust loss provisions in Schedule 2F to the ITAA 1936. Those provisions require a trust to pass certain tests (eg, that there is no change in its ownership) before it can access its tax losses. However, that requirement is not imposed on an 'excepted trust'. Section 272-100 defines ***excepted trust*** to mean a trust that (among other things) has all its income and capital beneficially owned by entities exempt under Division 50 of the ITAA 1997. If any of its income or capital were owned by a state or territory body that is exempt from tax but not under Division 50, the trust would not be an excepted trust and would have to satisfy the normal tests before it could access its tax losses.

Exempt entities

7.9 These amendments replace the definition of 'exempt entity' with one that makes any entity an ***exempt entity*** if *all its income* (regardless of what kind of income it is) is exempt from income tax under any Commonwealth law or it is an untaxable Commonwealth entity. ***[Schedule 7, item 14, subsection 995-1(1) of the ITAA 1997, definition of 'exempt entity']***

7.10 These amendments ensure that state and territory bodies exempted by Division 1AB of Part III of the ITAA 1936 and untaxable Commonwealth entities are treated consistently with entities exempted by Division 50 of the ITAA 1997.

7.11 Requiring that an entity is an exempt entity only if *all of* its income must be exempt from income tax clarifies that an entity is not an exempt entity merely because some of its income is exempt from tax or because in a particular year it happens to only earn exempt income. Instead, an entity will only be an exempt entity if a provision of a law exempts all income the entity could earn.

Untaxable Commonwealth entities

7.12 An untaxable Commonwealth entity is an agency (eg, a department), or an authority, that cannot be made liable to taxation by a Commonwealth law because, for example, it is necessarily immune to taxation or because it has no separate legal personality. The expression is defined in subsection 177-1(5) of the *A New Tax System (Goods and Services Tax) Act 1999.*

Excepted trusts

7.13 The amendments also alter the definition of 'excepted trust' in section 272-100 of Schedule 2F to the ITAA 1936 so that it requires all the interests in the income and capital of the trust to be held by 'exempt entities'. ***[Schedule 7, item 1, paragraph 272-100(d) in Schedule 2F to the ITAA 1936]***

7.14 Again, this ensures that state and territory bodies exempted by Division 1AB of Part III of the ITAA 1936 are treated consistently with entities exempted by Division 50 of the ITAA 1997.

Other minor technical corrections

7.15 The amendments make some minor technical corrections to Division 58 of the ITAA 1997. None of them change the intended operation of the law.

Missing asterisk

7.16 In the ITAA 1997, defined terms are marked by an asterisk (eg, '*exempt entity') so that readers can readily identify them. The amendments add a missing asterisk. ***[Schedule 7, item 2, paragraph 58-5(2)(a) of the ITAA 1997]***

References to 'person'

7.17 Division 58 deals with the income tax treatment of assets previously owned by exempt entities. Some of its provisions refer to future actions taken by 'the purchaser or another person'. In the ITAA 1936, the term 'person' is often used to cover all types of entity to which the law applies (ie, as a synonym for 'taxpayer'). However, in the ITAA 1997, the preferred way to describe the widest category of entities is to use the term 'entity' itself. Therefore, the amendments replace all Division 58 references to a 'person' with references to an 'entity'. ***[Schedule 7, items 7 to 11, subparagraphs 58-10(2)(b)(i) to (iii), and paragraphs 58-10(1)(a), (2)(a) and (2)(c)]***

Application and transitional provisions

General application provisions

7.18 The amendment to the definition of 'exempt entity' applies from 1 July 2005. This ensures that the amendment applies from the same time as the amendment made by the *Tax Laws Amendment*

(2005 Measures No. 3) Act 2005 to exempt public ancillary funds and prescribed private funds that provide money to other exempt entities. Aligning the application of the amendments ensures that those funds retain their tax-exempt status back to 1 July 2005 even if they later donated money to a Commonwealth, state or territory body that was exempt from tax but not technically an 'exempt entity'. ***[Subclause 2(1), item 4 in the table]***

7.19 The amendment to the definition of 'excepted trust' applies from Royal Assent. ***[Subclause 2(1), item 3 in the table]***

Transitional provisions

7.20 Although the amendment to the definition of 'exempt entity' applies from 1 July 2005, transitional provisions prevent the amendment applying to:

- entitlements to the research and development (R&D) tax offset affected by subsection 73J(2) of the ITAA 1936 until the first income year starting after Royal Assent ***[Schedule 7, item 15, and subclause 2(1), item 5 in the table]***; and
- entitlements to input tax credits affected by subsection 69-5(4) of the *A New Tax System (Goods and Services Tax) Act 1999* in relation to net amounts for tax periods starting before Royal Assent ***[Schedule 7, item 16, and subclause 2(1), item 5 in the table].***

R&D tax offset

7.21 The R&D provisions encourage R&D activities by providing an accelerated rate of deduction for R&D expenditure. As many R&D companies do not have a positive cash flow in their starting years, the benefit of the deduction would be deferred. So, in 2001, the law was amended to allow small and medium businesses to choose a refundable tax offset instead, so that the benefit could be accessed immediately in the form of a cash payment.

7.22 However, the choice of a tax offset was not allowed to R&D companies that were at least 25 per cent controlled by 'exempt entities'. This was to prevent exempt entities obtaining the benefit of the R&D tax offset.

7.23 This amendment ensures that the offset is not available to R&D companies at least 25 per cent owned by entities all of whose income is exempted from tax. A transitional provision ensures that the amendment

does *not* apply retrospectively to deny tax offsets already claimed by R&D companies.

Goods and services tax

7.24 The goods and services tax law works by charging GST on supplies an enterprise makes but allowing input tax credits for GST the enterprise pays on inputs to make those supplies. In effect, the enterprise only pays GST on the value it adds.

7.25 The GST law denies input tax credits for a range of expenses that are denied deductibility under the income tax law (eg, entertainment expenses). The reasons for denying the input tax credits are the same as those for denying the income tax deductions.

7.26 Because they have no deductions to deny, the GST law expressly extends the denial of input tax credits for those expenses to 'exempt entities' (see subsection 69-5(4) of the *A New Tax System (Goods and Services Tax) Act 1999*). This ensures that exempt entities are treated in the same way as other enterprises.

7.27 This amendment ensures that *all* entities exempted from income tax are denied input tax credits. A transitional provision ensures that the amendment does not apply retrospectively to deny input tax credits that might already have been claimed.

Consequential amendments

7.28 There is a separate definition of 'exempt entity' for the purposes of Division 58 of the ITAA 1997 (about the tax treatment of an exempt entity's depreciating assets when the entity or the assets are sold). That separate definition is substantially the same as the general definition but also includes 'exempt Australian government agencies'. Most things covered by that term would be 'exempt entities' within the proposed new definition. The exceptions are the Commonwealth, the States and the Territories, which are exempt Australian government agencies but not necessarily exempt entities.

7.29 The ITAA 1997 generally aims to have only one definition for each defined term. So, instead of maintaining the separate definition of 'exempt entity' for Division 58, the amendments add references to the Commonwealth, the States and the Territories, in each of the relevant places in Division 58. That preserves both the existing operation of Division 58 and the drafting preference for only defining each term in one way. ***[Schedule 7, items 3 to 9 and 11 to 13, subparagraph 58-10(2)(b)(i),***

paragraphs 58-5(4)(a) and (b), 58-5(5)(a), 58-10(1)(a), 58-10(2)(a) and (c) and 58-85(1)(a) and subsection 58-10(1) of the ITAA 1997]

7.30 The consequential amendments commence on 1 July 2005, to match the commencement of the new definition of 'exempt entity'. ***[Subclause 2(1), item 4 in the table]***

Chapter 8
Venture capital

Outline of chapter

8.1 Schedule 8 to this Bill amends the venture capital regime by:

- relaxing the eligibility requirements for concessional taxation treatment for foreign residents investing in venture capital limited partnerships (VCLPs) and Australian venture capital funds of funds (AFOFs); and

- providing taxation concessions for Australian residents and foreign residents investing in early stage venture capital activities through a new investment vehicle called an early stage venture capital limited partnership (ESVCLP).

8.2 Amendments are made to close the pooled development fund (PDF) scheme to new applications as a result of the introduction of the ESVCLP investment vehicle.

8.3 A technical amendment is also made to the regime in relation to the conditional registration of VCLPs and AFOFs.

Context of amendments

8.4 In the 2006-07 Budget, the Government announced a package of measures aimed at increasing activity in the venture capital sector (Treasurer's Press Release No. 37 of 9 May 2006). This measure addresses key findings of the *Review of Venture Capital Industry* and demonstrates the Government's ongoing support for Australia's venture capital sector.

8.5 The venture capital regime was introduced in 2002 to provide an incentive for foreign investors from specified countries to invest in the Australian venture capital industry, to develop the Australian industry and to provide a source of equity capital for relatively high risk and expanding businesses which find it difficult to attract investment through normal commercial mechanisms.

8.6 The *Venture Capital Act 2002* (VC Act) provides for the registration, administration and regulation of limited partnerships under the venture capital regime. Taxation concessions are provided under the *Income Tax Assessment Act 1997* (ITAA 1997) and the *Income Tax Assessment Act 1936* (ITAA 1936).

8.7 Eligible foreign resident partners in VCLPs or AFOFs are exempt from tax on their share of the profit or gain made on the limited partnership's disposal of an eligible venture capital investment. The limited partnership is treated as an ordinary partnership rather than as a corporate limited partnership. The concessional taxation treatment is provided by Subdivision 118-F (capital gains tax (CGT) exemption for venture capital investment) of the ITAA 1997, sections 51-54 and 51-55 (exemption for gains or profits) of the ITAA 1997 and section 94D (treatment as ordinary partnerships) of the ITAA 1936.

Summary of new law

8.8 This measure enhances the existing venture capital regime by:

- relaxing the eligibility requirements for concessional taxation treatment for foreign residents investing in VCLPs and AFOFs by:
  - allowing eligible venture capital investments to be acquisitions of units in units trusts and convertible notes, that are equity interests, in companies and unit trusts;
  - allowing some investments (up to 20 per cent of committed capital) to be in companies and unit trusts that are not located in Australia;
  - allowing limited partners to be residents of any foreign country and general partners and VCLPs to be resident of, or established in, countries with which Australia has a double tax agreement in force;
  - allowing auditors to be appointed at the end of the financial year in which an investment is made; and
  - reducing the minimum partnership capital required for registration as a limited partnership under the VC Act to $10 million; and

- providing taxation concessions for Australian residents and foreign residents investing in early stage venture capital activities through a new investment vehicle called an ESVCLP with the following features:
  - the committed capital of the ESVCLP cannot exceed $100 million;
  - an investment by an ESVCLP in any one entity cannot exceed 30 per cent of the ESVCLP's committed capital;
  - the size of the investee entity immediately before the investment is made by the ESVCLP must not exceed $50 million;
  - the ESVCLP must not continue to hold investments in an entity once the size of the entity exceeds $250 million;
  - the ESVCLP must have an investment plan approved by the Venture Capital Registration Board (VCR Board);
  - the ESVCLP must report to the VCR Board on the implementation of its approved investment plan; and
  - the VCR Board will publish the reports and make them publicly available.

Comparison of key features of new law and current law

New law	*Current law*
Relaxing eligibility requirements	
Allowing investments to be made through the acquisition of convertible notes, that are equity interests, and investments in unit trusts.	Investments must be acquisitions of shares or options in companies.
Allowing some investments to be made in companies and unit trusts that are not located in Australia.	The investee company must be an Australian resident and be located in Australia for at least 12 months after the first investment is made by the investor.

New law	***Current law***
Allowing limited partners to be residents of any foreign country and general partners and VCLPs to be residents of, or established in, countries with which Australia has a double tax agreement in force.	Limited partners, general partners and VCLPs must be residents of, or established in, certain specified foreign countries.
Allowing auditors to be appointed at the end of the financial year in which an investment is made.	An auditor is required on an ongoing basis including at the time of making an investment.
Reducing the minimum committed capital required for registration as a limited partnership to $10 million.	The minimum committed capital required for registration as a limited partnership is $20 million.
Providing taxation concessions for ESVCLPs	
Establishing registration and reporting requirements for the new ESVCLP investment vehicle.	No equivalent.
Treating ESVCLPs as ordinary partnerships, or ‘flow-through’ vehicles, for tax purposes.	Limited partnerships are generally taxed as companies under Australian tax law.
Exempting all the partners of an ESVCLP from tax on their share of the income and gains derived from eligible early stage venture capital investments.	No equivalent.
Closure of PDF regime	
Closing the PDF regime to new applications. The scheme will continue to operate for PDFs registered at the closure date of the scheme.	Eligible investment companies formed in Australia may be registered as PDFs. PDFs may make eligible investments in Australian resident companies and receive concessional taxation treatment on certain income.
Technical amendment	
Ensuring that partners in conditionally registered VCLPs and AFOFs that become fully registered are entitled to the tax exemption on any income or gains derived from eligible investments made while conditionally registered. This treatment will also apply to ESVCLPs.	Partners in VCLPs and AFOFs are not entitled to tax concessions in relation to investments made while the partnership was conditionally registered.

Detailed explanation of new law

Part 1 — Relaxing eligibility requirements

8.9 The venture capital regime was introduced in 2002 to provide an incentive for foreign investors from certain countries to invest in the Australian venture capital industry, to develop the Australian industry and to provide a source of equity capital for relatively high risk and expanding businesses which found it difficult to attract investment through normal commercial mechanisms.

8.10 This measure relaxes the eligibility requirements for the venture capital regime, without changing its intrinsic nature, by:

- allowing eligible venture capital investments to be acquisitions of units in unit trusts and convertible notes, that are equity interests, in companies and unit trusts;
- allowing some investments (up to 20 per cent of committed capital) to be in companies and unit trusts that are not located in Australia;
- allowing limited partners to be residents of any foreign country and general partners and VCLPs to be resident of, or established in, any country with which Australia has a double tax agreement in force;
- allowing auditors to be appointed at the end of the financial year in which an investment is made; and
- reducing the minimum partnership capital required for registration as a limited partnership under the VC Act to $10 million.

Investments in convertible notes and unit trusts

Convertible notes that are equity interests

8.11 Certain venture capital investments qualify for concessional taxation treatment under Subdivision 118-F of the ITAA 1997. Section 118-425 of the ITAA 1997 defines an ‘eligible venture capital investment’ to be, broadly, an investment in a company or a holding company that is at risk and has been made through the acquisition of shares or options. Amendments are made to Subdivision 118-F of the ITAA 1997 to allow eligible investments to be made through the

acquisition of convertible notes, that are equity interests, and to allow investments to be made in unit trusts.

8.12 Section 118-425 of the ITAA 1997 is amended to extend the definition of 'eligible venture capital investment' in a company to include an acquisition of convertible notes, that are equity interests, issued by the company ***[Schedule 8, items 27 to 29 and 34, paragraph 118-425(1)(b) and subparagraphs 118-425(1)(b)(ii) and (iii) and subsection 118-425(9) of the ITAA 1997].*** Debt interests continue to be excluded from eligible venture capital investments because they do not satisfy the requirement for the investment to be at risk (paragraph 118-425(1)(a) and section 118-430 of the ITAA 1997). Division 974 of the ITAA 1997 sets out the tests for determining whether an interest is a debt interest or an equity interest for tax purposes.

8.13 Amendments are also made to extend the definition of eligible venture capital investment to include the acquisition of convertible notes, that are equity interests, in holding companies. ***[Schedule 8, items 38 and 40, paragraph 118-425(11)(a) and subparagraphs 118-425(11)(c)(i) and (ia)]***

8.14 As a result of allowing eligible investments to include the acquisition of convertible notes that are equity interests, consequential amendments are made to Subdivision 118-F of the ITAA 1997 to include references to convertible notes. ***[Schedule 8, items 15, 17, 24 to 27, 38 and 40, subsection 118-410(4) (heading), subsection 118-415(3) (heading), subsection 118-425(9), paragraph 118-425(11)(a), subparagraph 118-425(11)(c)(i) and subsection 118-425(15A)]***

Unit trusts

8.15 Section 118-427 is inserted in Subdivision 118-F to allow venture capital investments to be acquisitions of units in unit trusts ***[Schedule 8, item 44, section 118-427 of the ITAA 1997].*** For an investment in a unit trust to be an eligible venture capital investment, certain requirements must be met. The requirements are comparable to those applying to investments in companies but changes have been made to reflect the terminology and concepts for unit trusts. The requirements are:

- the investment must be either an acquisition of units in the unit trust, an acquisition of options or an acquisition of convertible notes, that are equity interests, issued by or on behalf of the unit trust ***[Schedule 8, item 44, paragraph 118-427(1)(b) of the ITAA 1997]***;

- the investment must be at risk; that is, there can be no arrangement, agreement or similar undertaking to guarantee the value of the units or any distributions or entitlements to income or capital from the unit trust ***[Schedule 8, items 44 to 46, paragraph 118-427(1)(a), paragraphs 118-430(a) and (b) of the ITAA 1997]***;

- the total amount of the partnership interest in the unit trust, together with its interests in any connected entities of the unit trust, cannot exceed 30 per cent of the partnership's committed capital (as defined in subsection 995-1(1) and section 118-445 of the ITAA 1997) ***[Schedule 8, item 44, paragraph 118-427(1)(d) and subsection 118-427(2) of the ITAA 1997]***;

- immediately prior to the making of the investment, the unit trust must not exceed the permitted entity value (defined in section 118-440 of the ITAA 1997) of either $250 million in the case of investments made by VCLPs or $50 million for investments made by ESVCLPs (see below for an explanation of ESVCLPs) ***[Schedule 8, items 44, 52 and 131 to 138, paragraph 118-427(1)(c), subsection 118-427(7), subsection 118-440(1) (note), subsection 118-440(1), subsections 118-440(3) and (5), paragraphs 118-440(5)(a) and (b), paragraphs 118-440(7)(a) and (c), subsections 118-440(8) and (9) of the ITAA 1997]***;

- at the time the investment is made, the unit trust must not be listed on a stock exchange in Australia or a foreign country or, if it is listed, it must cease to be listed within 12 months of the investment being made ***[Schedule 8, item 44, paragraph 118-427(1)(c) and subsection 118-427(8) of the ITAA 1997]***;

- at the time the investment is made:

  – the unit trust must have its location in Australia; that is, the unit trust must carry on business in Australia and either have its central management and control in Australia or have more than 50 per cent of the beneficial interests in the trust income or property held by Australian residents; and

  – if it is the entity's first investment in the unit trust, the unit trust must also have more than 50 per cent of its employees and assets located in Australia for 12 months after the investment is made, unless a shorter time is specified under section 25-5 of the VC Act,

however, if the value of the investment at the time it is made and the value of all other investments owned by the entity at that time does not exceed 20 per cent of the entity's committed capital, the unit trust is treated as satisfying this location in Australia requirements ***[Schedule 8, item 44, paragraph 118-427(1)(c), subsections 118-427(3) and (13) of the ITAA 1997]***;

- the predominant activity of the unit trust cannot be:
  - property development or land ownership;
  - finance, to the extent that it is banking, providing capital to others, leasing, factoring or securitisation;
  - insurance;
  - construction and/or acquisition of infrastructure facilities; and
  - investments deriving income from interest, rents, dividends, royalties or lease payments;

[Schedule 8, item 44, paragraph 118-427(1)(c) and subsections 118-427(4) and (14) of the ITAA 1997]

- the unit trust must have a registered auditor at the end of the income year in which the investment is made and at all times thereafter ***[Schedule 8, item 44, paragraph 118-427(1)(c) and subsection 118-427(6) of the ITAA 1997]***;
- the unit trust must not invest any part of the investment in another entity unless the other entity is connected with the trustee of the unit trust and satisfies the requirements applying to the unit trust; however, deposits made with authorised deposit-taking institutions are allowed ***[Schedule 8, item 44, paragraph 118-427(1)(c) and subsection 118-427(5) of the ITAA 1997]***; and
- if units are acquired in exchange for all of the units in a unit trust that satisfies the requirements of an eligible investment, the replacement units will be treated as an eligible investment even if the requirements are not met by that unit trust ***[Schedule 8, item 44, subsection 118-427(9) of the ITAA 1997].***

8.16 Section 118-427 applies to consolidated and consolidatable groups where a unit trust is able to choose or has chosen to be the head

company under section 713-130 of the ITAA 1997. This provision also applies to unit trusts that are not corporate unit trusts and public trading trusts as if they were those types of trusts. ***[Schedule 8, item 44, subsection 118-427(12) of the ITAA 1997]***

8.17 As a result of allowing investments to be made in unit trusts, consequential amendments are made to Subdivision 118-F of the ITAA 1997. ***[Schedule 8, items 1, 6, 16, 18, 26, 39, 41, 42 and 47 to 53, section 118-400, subsections 118-405(4) to (7), subsections 118-410(5) and (6), subsections 118-415(4) to (6), section 118-425 (heading), paragraph 118-435(2)(b), paragraph 118-425(11)(b), subparagraph 118-425(11)(c)(iii), paragraph 118-425(11)(d), paragraphs 118-435(1)(b) to (d), paragraphs 118-435(2)(c) and (d), subsection 118-440(1) (note) and subsection 995-1(1) (definition of 'eligible venture capital investment') of the ITAA 1997]***

8.18 Amendments are also made to the VC Act to extend its operation to include investments made in units in unit trusts. ***[Schedule 8, items 56 to 84, paragraph 9-1(1)(e), subparagraphs 9-1(1)(e)(ii) and (iii), paragraph 9-1(1)(f), subparagraphs 9-5(1)(d)(ii) to (iv), paragraph 9-5(1)(e), paragraph 9-10(1)(aa), paragraph 15-1(ga), paragraph 15-1(gb), paragraphs 15-10(c), to (f), paragraph 21-5(3)(d), paragraph 21-5(3)(f), paragraph 21-20(1)(g), paragraph 21-20(1)(h), paragraph 21-20(1)(j), paragraph 21-20(1)(k), paragraph 21-20(1)(l), section 25-1, section 25-1 (note), subsections 25-5(1A) and (2), subsections 25-10(1A) and (2), subsections 25-15(1A) and (2) of the VC Act]***

Location in Australia

8.19 The requirement that investee entities must be located within Australia for an investment to be an eligible venture capital investment is being relaxed. The current requirement in subsection 118-425(2) of the ITAA 1997 provides that at the time the investment is made:

- the company must be an Australian resident; and
- if it is the entity's first investment in the company, the company must also have more than 50 per cent of its employees and assets located in Australia for 12 months after the investment is made, unless a shorter time is specified under section 25-5 of the VC Act.

8.20 An amendment is made to allow no more than 20 per cent of the entity's committed capital to be made in investee entities that do not comply with this requirement. Where the sum of the value of the investment at the time it is made and the value of all other investments owned by the entity at that time does not exceed 20 per cent of the entity's committed capital, the investment may be made in an entity that does not satisfy the location in Australia requirement. ***[Schedule 8, items 30 and 43, subsection 118-425(2) and subsection 118-425(12A) of the ITAA 1997]***

8.21 The value of an investment is the value shown in the last audited accounts of the entity or in a statement prepared in accordance with accounting standards. ***[Schedule 8, items 35 to 37, subsection 118-425(10) (heading) and subsection 118-425(10) of the ITAA 1997]***

Residency requirements

8.22 Changes are being made to the residency requirements for limited partners, general partners and VCLPs as a result of the reforms to the CGT treatment of foreign residents. The CGT changes have removed the incidence of Australian CGT on most assets held by foreign residents. Therefore, the restriction of the venture capital concessions to certain foreign residents is being relaxed.

8.23 The restriction on the country of residence of limited partners is being removed to allow a wider range of non-residents to invest in the Australian venture capital industry. Section 118-420 of the ITAA 1997 defines an 'eligible venture capital partner' to be, broadly, a tax-exempt foreign resident, a foreign venture capital fund of funds or a taxable foreign resident whose share of the partnership's committed capital is not more than 10 per cent. Currently, tax-exempt foreign residents and foreign venture capital funds of funds must be either residents of, or established in, Canada, France, Germany, Japan, the United Kingdom or the United States of America. Taxable foreign residents must be residents of Canada, Finland, France, Germany, Italy, Japan, the Netherlands, New Zealand, Norway, Sweden, Taiwan, the United Kingdom or the United States of America. Amendments are made to section 118-420 to allow limited partners to be resident of any foreign country. ***[Schedule 8, items 19 to 25, paragraph 118-420(1)(c), paragraph 118-420(3)(b), paragraphs 118-420(4)(a) and (b), paragraphs 118-420(5)(b) and (c) and subsection 118-420(6)]***

8.24 Amendments are also made to relax the residency requirements for general partners and VCLPs. Currently, VCLPs must be established in Australia, Canada, France, Germany, Japan, the United Kingdom or the United States of America and general partners must be residents of one of those countries (section 9-1 of the VC Act). These requirements are being relaxed and extended to VCLPs and general partners resident in, or established in, any country with which Australia has a double tax agreement in force. ***[Schedule 8, item 54, paragraph 9-1(1)(a) of the VC Act]***

Appointment of auditors

8.25 Subsection 118-425(5) requires that an investee company must have a registered auditor at the time the investment is made. This requirement is being amended to allow the appointment of a registered auditor to be made at any time during the income year in which the

investment is made. If the company does not have a registered auditor at the end of the year in which the investment is made, and at all times thereafter, the investment will not be an eligible venture capital investment and will not be eligible for concessional tax treatment under Subdivision 118-F. ***[Schedule 8, items 31 to 33, subsection 118-425(5), paragraphs 118-425(5)(a) and (b) and subsection 118-425(5) (note) of the ITAA 1997]***

8.26 Consistent with this requirement, an investee unit trust must have a registered auditor appointed at the end of the income year in which the investment is made and at all times thereafter. ***[Schedule 8, item 44, subsection 118-427(6) of the ITAA 1997]***

Minimum partnership capital

8.27 One of the registration requirements for a limited partnership under section 9-1 of the VC Act is that a minimum amount of partnership committed capital is required. The minimum amount of committed capital is being reduced from $20 million to $10 million to assist fund raising for investments, in particular, by small funds. ***[Schedule 8, item 55, paragraph 9-1(1)(d) of the VC Act]***

Part 2 — Providing taxation concessions for early stage venture capital limited partnerships

8.28 The venture capital regime is being enhanced by the introduction of a new limited partnership investment vehicle. The new investment vehicle is an early stage limited capital partnership, or ESVCLP, and is designed to encourage investments in start-up enterprises with a view to commercialisation of the activity. The introduction of the ESVCLP will stimulate activity in the venture capital sector and enhance the development of skills and the formation of capital.

8.29 The new investment vehicle is replacing the PDF corporate structure with a more relevant and internationally recognised limited partnership structure. As a result, the PDF scheme is being closed to new applications but will continue to operate for registered PDFs.

8.30 Registration, regulation and administration of ESVCLPs is to be provided under the VC Act. The functions of the PDF Board are being extended to include the new investment vehicle. As a result, the name of the PDF Board is being changed to the VCR Board.

8.31 The structure of the ESVCLP scheme is similar to that for VCLPs, with additional requirements to ensure the integrity of the regime. ESVCLPs will be treated as flow-through vehicles for tax purposes and resident and foreign partners will be exempt from income tax on all

income or gains derived from eligible investments made through the vehicle.

8.32 To ensure that investments made by ESVCLPs are targeted at early stage activities, the new regime has the following distinguishing features:

- the committed capital of the ESVCLP cannot exceed $100 million;
- an investment by an ESVCLP in any one entity cannot exceed 30 per cent of the ESVCLP's committed capital;
- the size of the investee entity immediately before the investment is made by the ESVCLP must not exceed $50 million;
- the ESVCLP must not continue to hold investments in an entity once the size of the entity exceeds $250 million;
- the ESVCLP must have an investment plan approved by the VCR Board;
- the ESVCLP must report to the VCR Board on the implementation of its approved investment plan; and
- the VCR Board will publish the reports and make them publicly available.

8.33 The explanation of the new law has the following structure:

- the concessional tax treatment for ESVCLPs:
  - eligible venture capital investments held by ESVCLPs;
  - flow-through treatment;
  - treatment of capital gains and losses;
  - income exemption;
  - treatment of losses; and
  - treatment of carried interests; and
- the regulation of ESVCLPs:

- registration requirements;
- application for registration;
- obligations while registered;
- revocation of registration;
- determinations by the Board; and
- review of decisions.

Concessional tax treatment for ESVCLPs

8.34 A limited partnership is an ESVCLP if its registration as an ESVCLP is in force under Part 2 of the VC Act. ***[Schedule 8, items 119, 149 and 150, subsection 118-407(4) and subsection 995-1(1) (definitions of 'early stage venture capital limited' and 'ESVCLP') of the ITAA 1997]***

Eligible venture capital investments held by ESVCLPs

8.35 Sections 118-425 and 118-427 of the ITAA 1997 define the meaning of eligible venture capital investments in companies and unit trusts respectively. These definitions are relevant for investments made by ESVCLPs as well as VCLPs and AFOFs. There is a variation in these requirements for ESVCLPs relating to the permitted entity value of the investee entity immediately before the investment is made.

8.36 The ***permitted entity value of an investee entity*** is defined in section 118-440 of the ITAA 1997 as the sum of the value of the entity's assets and the value of the assets of any entity connected with the entity (with an adjustment to ensure that assets are not double-counted to both the entity and connected entities). ESVCLPs can only invest in entities with a permitted entity value of $50 million or less immediately before the investment is made. ***[Schedule 8, items 131 to 138, subsections 118-440(1), (3) and (5), paragraphs 118-440(5)(a) and (b), paragraphs 118-440(7)(a) and (c), subsections 118-440(8) and (9) of the ITAA 1997]***

8.37 Section 118-428 of the ITAA contains 'additional investment requirements' that must be satisfied by ESVCLPs. The requirements relate to listing on a stock exchange of an investee entity and the purchase of pre-owned investments by ESVCLPs. A definition is inserted in subsection 995-1(1) of the ITAA 1997. ***[Schedule 8, item 145, subsection 995-1(1) (definition of 'additional investment' requirement for ESVCLPs)]***

8.38 If, at the time of making an investment in an entity, the ESVCLP does not already own an investment in the entity, the entity cannot be

listed on an Australian or foreign stock exchange. However, if the ESVCLP already owns an investment in the entity, the entity may be listed on an Australian or foreign stock exchange. ***[Schedule 8, item 130, paragraph 118-428(1)(a) of the ITAA 1997]***

8.39 A pre-owned investment can only be acquired in an entity by an ESVCLP if:

- either:
  - the ESVCLP already owns an investment in the entity; or
  - the ESVCLP will be making investments that are not pre-owned investments at the same time; and
- the sum of the value of the pre-owned investment at the time of investment and the value of all other pre-owned investments that the ESVCLP owns does not exceed 20 per cent of the partnership's committed capital.

[Schedule 8, items 130 and 154, paragraphs 118-428(1)(b) and (c) and subsection 995-1(1) (definition of 'pre-owned') of the ITAA 1997]

8.40 A ***pre-owned investment*** is defined as an investment that was issued or allotted to an entity other than the ESVCLP. An investment will be a pre-owned investment if the ESVCLP acquires it on a secondary market. ***[Schedule 8, item 130, subsection 118-428(2) of the ITAA 1997]***

8.41 The value of an investment is the value recorded in the audited accounts or in a statement prepared in accordance with accounting standards. ***[Schedule 8, item 130, subsection 118-428(3) of the ITAA 1997]***

Flow-through tax treatment

8.42 An ESVCLP is taxed as an ordinary partnership rather than as a corporate limited partnership under Division 5A of Part III of the ITAA 1936. Division 5A taxes certain limited partnerships as companies. Section 94D of the ITAA 1936 defines a 'corporate limited partnership' and is amended to exclude ESVCLPs from the definition. This amendment ensures that ESVCLPs are taxed as flow-through vehicles under Division 5 of Part III of the ITAA 1936; that is, the partners are taxed on their share of the net income of the partnership according to their own tax status. ***[Schedule 8, items 89 to 94, subsection 94D(2), subsection 94D(2) (notes 1 to 3), paragraph 94D(3)(a) and subparagraph 94D(3)(a)(ia) of the ITAA 1936]***

8.43 Under Division 5 of Part III of the ITAA 1936, each partner is assessable on its share of the partnership net income and is allowed a deduction for its share of a partnership loss. Unlike partners in an ordinary partnership, limited partners are only liable for the debts of the limited partnership to the extent of their investment in the partnership. Therefore, amendments are made to Division 5 to limit the amount of loss that is deductible to a limited partner of an ESVCLP to the extent of their financial exposure. This is consistent with the treatment for limited partners of VCLPs and AFOFs. ***[Schedule 8, item 88, paragraphs 92(2AA)(b) and 92A(1)(b) of the ITAA 1936]***

Capital gains and losses

8.44 Under section 118-407 of the ITAA 1997, a partner's share of a capital gain or loss from an ESVCLP that arises in relation to eligible venture capital investments is exempt from income tax if the following conditions are met:

- the partner is a partner in a limited partnership ***[Schedule 8, item 119, paragraph 118-407(1)(a) of the ITAA 1997]***;
- if the partner is a general partner, the general partner is either an Australian resident or a resident of a country with which Australia has a double tax agreement in force ***[Schedule 8, item 119, subsection 118-407(2) of the ITAA 1997]***;
- the CGT event arises in relation to an eligible venture capital investment made by the partnership and the additional investment requirements have been met ***[Schedule 8, item 119, paragraph 118-407(1)(b) of the ITAA 1997]***;
- the partnership was unconditionally registered (as defined in subsection 995-1(1) of the ITAA 1997) as an ESVCLP when the investment was made ***[Schedule 8, item 119, paragraph 118-407(1)(c) of the ITAA 1997]***; and
- at the time of the CGT event, the ESVCLP:
  - was unconditionally registered;
  - satisfied the registration requirements of section 9-3 of the VC Act, other than the investment registration requirements but including the divestiture registration requirement; and

– owned the investment and had owned the investment for at least 12 months ***[Schedule 8, item 119, paragraph 118-407(1)(d) of the ITAA 1997].***

8.45 When a general partner is:

- not an Australian resident; and
- a company or a limited partnership,

the place of residence of the general partner is where the general partner has its central management and control. ***[Schedule 8, item 119, subsection 118-407(3) of the ITAA 1997]***

8.46 A partnership is treated as having met the divestiture registration requirement if, having failed to meet the requirement at the start of an income year, it meets the requirement within six months of that time (or a longer period as extended under subsection 17-3(3) of the VC Act). ***[Schedule 8, item 119, subsection 118-407(5) of the ITAA 1997]***

8.47 A definition of the 'divestiture registration requirement' is included in subsection 995-1(1) of the ITAA 1997 to have the meaning given by subsection 9-3(3) of the VC Act (see paragraph 8.60). ***[Schedule 8, item 148, definition of 'divesture registration requirement' in subsection 995-1(1) of the ITAA 1997]***

Income

8.48 An income tax exemption is also provided for an entity's share of any income derived from eligible venture capital investments, for example dividends and a share of a capital gain to which a unitholder is entitled, if the following conditions are met:

- the entity is a partner in a limited partnership ***[Schedule 8, item 105, paragraph 51-52(1)(a) of the ITAA 1997]***;
- if the entity is a general partner, the general partner is either an Australian resident or a resident of a country with which Australia has a double tax agreement in force ***[Schedule 8, item 105, subsection 51-52(3) of the ITAA 1997]***;
- the partnership made the investment and was unconditionally registered as an ESVCLP when it made the investment ***[Schedule 8, item 105, paragraphs 51-52(1)(b) and (d) of the ITAA 1997]***;

- the investment met the additional investment requirements ***[Schedule 8, item 105, paragraph 51-52(1)(c) of the ITAA 1997]***; and
- the partnership was unconditionally registered as an ESVCLP and owned the investment when the income was derived ***[Schedule 8, item 105, paragraph 51-52(1)(e) and subsection 51-52(5) of the ITAA 1997].***

8.49 When a general partner is:

- a foreign resident; and
- a company or a limited partnership,

the place of residence of the general partner is where the general partner has its central management and control. ***[Schedule 8, item 105, subsection 51-52(4) of the ITAA 1997]***

8.50 Section 51-54 of the ITAA 1997 provides an income tax exemption for any gains or profits arising from the disposal of eligible venture capital investments for partners in VCLPs and AFOFs. Amendments are made to extend this exemption to partners in ESVCLPs. ***[Schedule 8, items 106 to 109, subsection 51-54(1) (heading), paragraphs 51-54(1)(a) and (b) and subparagraph 51-54(2)(a)(ii) of the ITAA 1997]***

Losses

8.51 A partner's share of a loss arising from the disposal of an eligible venture capital investment by a VCLP or AFOF is not deductible under section 26-68 of the ITAA 1997. Amendments are made to extend this restriction to losses made by ESVCLPs on the disposal of eligible venture capital investments. ***[Schedule 8, items 100 to 103, subsection 26-68(1) (heading), paragraphs 26-68(1)(a) and (b) and subparagraph 26-68(2)(a)(ii) of the ITAA 1997]***

8.52 Subdivision 195-B of the ITAA 1997 quarantines losses incurred by a limited partnership prior to it becoming a VCLP or an AFOF. If the limited partnership ceases to be a VCLP or an AFOF, any tax loss quarantined can then be recouped. Amendments are made to extend the application of Subdivision 195-B to ESVCLPs. This means that any loss incurred by the limited partnership prior to becoming an ESVCLP cannot be utilised while it is an ESVCLP. ***[Schedule 8, items 139 to 144, section 195-60, section 195-65 (heading), section 195-65, section 195-70 (heading) and section 195-70 of the ITAA 1997]***

Carried interests

8.53 A venture capital general partner's share of the gains made by a VCLP or AFOF on the sale of the eligible venture capital investments, the carried interest, is taxed as a capital gain under section 104-255 of the ITAA 1997. The general partner makes a gain at the time an entitlement to receive a payment arises (CGT event K9). Amendments are made to section 104-255 to extend the treatment to general partners of ESVCLPs. Carried interests are specifically excluded from the income exemption provided by section 51-52. ***[Schedule 8, items 105, 110 to 115, subsection 51-52(6), subsections 104-255(1), (4) and (5), paragraphs 104-255(6)(a) and (b), paragraph 116-30(5)(a) and subsection 118-21(1) of the ITAA 1997]***

8.54 A consequential amendment is made to the definition of 'carried interest' in subsection 995-1(1) of the ITAA 1997 to extend its application to ESVCLPs. ***[Schedule 8, item 147, subsection 995-1(1) (paragraph (a) of the definition of 'carried interest') of the ITAA 1997]***

Consequential amendments

8.55 A number of consequential amendments are made to the ITAA 1936 and the ITAA 1997 as a result of the introduction of the ESVCLP in the venture capital regime. ***[Schedule 8, items 86, 87 and 95, subsection 6(1), subsections 18A(1) and (2) and subparagraph 128B(3)(h)(ii) of the ITAA 1936; items 96 to 99, 104, 116, 120 to 129, 151 to 153, 155 and 156, subsection 4-10(2) (note 2), subsection 9-5(2) (note 2), section 11-15 (item in the table dealing with foreign investment) and section 11-15, section 36-25, section 118-400, subsection 118-410(1) (heading), paragraphs 118-410(1)(b) and (f), subparagraph 118-410(1)(f)(iv), paragraphs 118-410(2)(b) and (d), paragraphs 118-420(4)(c) and (5)(d), paragraphs 118-425(8)(b) and (11)(a), subsection 995-1(1) (after paragraph (a) of the definition of 'investment registration requirement'), subsection 995-1(1) (paragraph (b) of the definition of 'limited partnership'), and subsection 995-1(1) (definition of 'unconditionally registered') of the ITAA 1997]***

The regulation of ESVCLPs

8.56 The VCR Board can register limited partnerships as ESVCLPs when the registration requirements of Division 9 of the VC Act are met. ***[Schedule 8, items 169 and 170, section 7-1 of the VC Act]***

Registration requirements

8.57 The registration requirements of an ESVCLP are listed in section 9-3 of the VC Act and can be categorised as general registration requirements, investment registration requirements and the divestiture registration requirement. All requirements must be met.

8.58 The general registration requirements are contained in paragraphs 9-3(1)(a) to (d) of the VC Act:

- the limited partnership was established under a law of Australia or a country with which Australia has a double tax agreement in force ***[Schedule 8, item 171, paragraph 9-3(1)(a) of the VC Act]***;

- all of the general partners of the partnership are residents of either Australia or one of the countries with which Australia has a double tax agreement in force ***[Schedule 8, item 171, paragraph 9-3(1)(b) of the VC Act]***;

- the partnership agreement provides that the partnership is to remain in existence for at least five years but not more than 15 years ***[Schedule 8, item 171, paragraph 9-3(1)(c) of the VC Act]***; and

- the committed capital of the partnership must be at least $10 million but cannot exceed $100 million ***[Schedule 8, item 171, paragraph 9-3(1)(d) of the VC Act].***

8.59 The investment registration requirements are contained in paragraphs 9-3(1)(e) to (h), (j) and (k) ***[Schedule 8, item 171, subsection 9-3(2) of the VC Act]***:

- the committed capital of any partner, together with associates (as defined in subsection 995-1(1) of the ITAA 1997), cannot exceed 30 per cent of the total committed capital of the partnership, unless:

  - the partner is an approved deposit-taking institution;

  - a life insurance company;

  - a public authority carrying on life insurance business;

  - a widely-held complying superannuation fund; or

  - the VCR Board otherwise approves;

  [Schedule 8, item 171, paragraph 9-3(1)(e), subsections 9-3(4) and (5) of the VC Act];

- all of the partnership's investments are eligible venture capital investments or would have been eligible venture capital investments had the investee company or unit trust

met the location in Australia and the permitted entity value requirements of the ITAA 1997 ***[Schedule 8, item 171, paragraph 9-3(1)(f) of the VC Act]***;

- each investment complies with the partnership's approved investment plan and the partnership acts in accordance with that plan ***[Schedule 8, item 171, paragraphs 9-3(1)(g) and (h) of the VC Act]***;

- the partnership does not carry on any activities which are not related to making eligible venture capital investments ***[Schedule 8, item 171, paragraph 9-3(1)(j) of the VC Act]***; and

- the only debt interests held by the partnership are permitted loans ***[Schedule 8, item 171, paragraph 9-3(1)(k) of the VC Act]***.

8.60 The 'divestiture registration requirement' is contained in paragraph 9-3(1)(i) of the VC Act ***[Schedule 8, item 171, subsection 9-3(3) of the VC Act]***:

- the partnership must not hold an investment if, at the end of the preceding income year, the sum of the total values of the assets of the investee entity and the assets of any connected entity of the investee exceed $250 million ***[Schedule 8, item 171, paragraph 9-3(1)(i) and subsection 9-3(6) of the VC Act]***.

Application for registration

8.61 The requirements for making a registration application that apply to VCLPs and AFOFs are contained in Division 11 of the VC Act. These requirements are extended to apply to ESVCLPs. ***[Schedule 8, items 175 and 176, subsection 11-1(1) and paragraph 11-1(2)(ja) of the VC Act]***

Registration

8.62 The VCR Board must register a limited partnership as an ESVCLP if:

- the application meets the requirements of section 11-1 of the VC Act;

- any additional information requested by the VCR Board under section 11-10 has been provided;

- the general partner has advised that the ESVCLP has sufficient funds to commence its investment programme; and

- the VCR Board is satisfied that:
  - the partnership's investment plan is appropriate; and
  - the partnership is able to implement the investment plan given the skills and resources to which it has access.

[Schedule 8, item 177, subsection 13-1(1A) of the VC Act]

8.63 The VCR Board is not required to register a limited partnership as an ESVCLP if the registration requirements have not been met or a previous registration has been revoked under Division 17 of the VC Act. ***[Schedule 8, item 177, paragraphs 13-1(1A)(g) and (h) of the VC Act]***

8.64 The VCR Board must notify the general partner as to whether registration has been granted and, if not granted, the reasons for the decision. ***[Schedule 8, item 178, subsections 13-1(3) and (4) of the VC Act]***

8.65 The VCR Board cannot register a limited partnership as:

- both as a VCLP and an ESVCLP;
- both as an ESVCLP and an AFOF;
- both as a VCLP and an AFOF; or
- as a VCLP, as an ESVCLP and as an AFOF.

[Schedule 8, item 179, subsection 13-1(5) of the VC Act]

8.66 Section 13-5 of the VC Act provides that the VCR Board may conditionally register a VCLP or an AFOF if the application requirements have not been met. Conditional registration is extended to ESVCLPs in the same circumstances. ***[Schedule 8, items 180, 181 and 182, subsections 13-5(1A) and (3) of the VC Act]***

8.67 Section 13-10 of the VC Act provides when registration is in force. Consequential amendments are made to extend its application to ESVCLPs. ***[Schedule 8, items 181 to 183, subsections 13-10(1) and (2) and subsection 13-10(3) of the VC Act]***

8.68 An ***approved investment plan*** for an ESVCLP is defined as:

- the investment plan referred to in the notice from the VCR Board advising the general partner that registration as an ESVCLP has been approved; or
- a replacement plan that is approved by the VCR Board.

8.69 An investment plan may be replaced if a general partner makes a request in writing to the VCR Board stating the reasons for replacement of the original plan. If the VCR Board is satisfied that the replacement plan is appropriate, it must grant the request for replacement and notify the general partner of the decision. If it is not satisfied as to the appropriateness of the replacement plan, it must refuse the request and advise the general partner of its reasons for the decision. ***[Schedule 8, item 184, section 13-15 of the VC Act]***

8.70 When determining under paragraph 13-1(1A)(c) whether an investment plan, or a replacement plan, is appropriate, the VCR Board must take into account the extent to which the limited partnership and its investments focus on early stage venture capital. In making this determination, the VCR Board may consider:

- the stages of development of the investee entities;
- the cash flow levels of the investee entities;
- the levels of technology of the investee entities;
- the proportion of intellectual property to total assets of the investee entities;
- the levels of risk and return of the investee entities;
- the amount of tangible assets and collateral of the investee entities against which borrowings may be secured;
- the legislative requirements for an ESVCLP to make and hold investments;
- whether the committed capital requirements of an ESVCLP are being circumvented; and
- any additional matters specified in guidelines issued by the VCR Board.

[Schedule 8, item 184, subsection 13-20(1) of the VC Act]

8.71 The VCR Board may issue guidelines, which are legislative instruments, specifying additional matters to be taken into account when deciding whether investment plans are appropriate. ***[Schedule 8, item 184, subsection 13-20(2) of the VC Act]***

8.72 It should be noted that these factors are indicative only and the VCR Board is not limited to these matters when deciding the

appropriateness of an investment plan. ***[Schedule 8, item 184, subsection 13-20(3) of the VC Act]***

Obligations while registered

8.73 The obligations imposed on VCLPs and AFOFs by Division 15 of the VC Act in relation to quarterly and annual returns are extended to ESVCLPs. ***[Schedule 8, items 185 to 187, section 15-1, paragraph 15-1(fa) and section 15-10 of the VC Act]***

8.74 An additional requirement is imposed on ESVCLPs to supply an annual report to the VCR Board within three months of the end of the financial year. The report must provide information on the implementation of the approved investment plan, including descriptions of investments made and disposed of during the financial year. The report is to be in a form or format specified by the VCR Board in guidelines issued by legislative instrument. The VCR Board will publish the reports, and may do so in its annual report to the Minister for Industry, Tourism and Resources which is tabled in Parliament. ***[Schedule 8, item 188, section 15-17 of the VC Act]***

Revocation of registration

8.75 The circumstances in which the VCR Board may revoke registrations under Division 17 of the VC Act are extended to ESVCLPs. If the VCR Board is of the view that an ESVCLP does not meet the registration requirements, the general partner must be notified that registration will be revoked unless the requirements are met. ***[Schedule 8, items 189 to 191 and 193 to 199, paragraph 17-1(1)(a), subsections 17-1(1) and (5), paragraph 17-5(1)(ab), subsections 17-5(1) and (6), subsection 17-10(1), subparagraph 17-10(1)(e)(i), section 17-15 and subsections 17-25(1) and 25-5(1) of the VC Act]***

8.76 In addition, registrations may be revoked for ESVCLPs when the divestiture registration requirement is not met. When an ESVCLP does not meet the divestiture registration requirement at the end of an income year and does not meet the requirement within six months of the end of the income year, the VCR Board must revoke the registration. However, a general partner may apply for an extension of time, of up to three months, in which to meet the requirement when there are circumstances justifying an extension. The VCR Board may issue guidelines by legislative instrument about the matters to be considered in granting extensions of time. ***[Schedule 8, item 192, section 17-3 of the VC Act]***

Determinations by the VCR Board

8.77 Division 25 of the VC Act allows the VCR Board to make determinations in relation to investments by VCLPs and AFOFs. These

provisions are to apply to ESVCLPs. ***[Schedule 8, items 200 and 201, subsections 25-10(1) and 25-15(1) of the VC Act]***

Review of decisions

8.78 Division 29 of the VC Act provides that decisions made by the VCR Board in relation to VCLPs and AFOFs are reviewable. Amendments are made to extend these provisions to ESVCLPs. ***[Schedule 8, items 202 to 204, paragraphs 29-1(aa), (b) and (c) of the VC Act]***

Consequential amendments

8.79 Consequential amendments are made to the VC Act to include references to ESVCLPs. ***[Schedule 8, items 166, 167, 168, 172, 173 and 174, section 3-5 (heading), paragraph 3-5(a), Part 2 (heading), subparagraph 9-5(1)(d)(i) and (ii) and paragraph 9-5(1)(e) of the VC Act]***

Venture Capital Registration Board

8.80 As a consequence of the introduction of the new venture capital investment vehicle, the functions of the PDF Registration Board are being extended to include the registration and monitoring of ESVCLPs. ***[Schedule 8, items 157 to 165, subsection 4(1), paragraph 6(3)(a), paragraph 6(3)(ab), paragraph 72(1)(c), paragraph 72(1)(ca), paragraph 73(1)(c), paragraph 73(1)(ca), paragraph 74(2)(c) and paragraph 74(2)(ca) of the Pooled Development Funds Act 1992 (PDF Act)]***

8.81 The expanded functions have resulted in the name of the PDF Registration Board being changed to the VCR Board. ***[Schedule 8, items 215, 216 and 217, subsection 4(1) (definition of 'Board'), Part 2 (heading) and section 5 of the PDF Act]***

8.82 Consequential amendments are made to replace references to the PDF Registration Board in the ITAA 1997 and the VC Act with references to the VCR Board. ***[Schedule 8, items 206 to 214, paragraph 118-425(2)(b), subsection 118-425(2), subsection 118-425(3) (note 3), subsection 118-425(14) (heading), subsection 118-425(14), subsection 995-1(1) (definition of 'form approved' by the PDF Board), and subsection 995-1(1) (definition of 'PDF Board') of the ITAA 1997, items 218 to 347, subsection 1-15(2), section 3-1 (note), paragraph 3-5(c), section 3-15 (heading), section 3-15, section 3-20, section 7-1, paragraph 9-10(1)(b), subsections 9-10(2) and (3), subsection 11-1(1), paragraph 11-1(2)(l), subsection 11-5(1), section 11-10, subsections 11-15(1) to (4), subsection 113-1(1), paragraph 113-1(1)(d), subsection 13-1(2), paragraph 13-1(2)(d), subsection 13-1(3), subsection 13-1(4), subsections 13-5(1) and (2), section 15-1, paragraph 15-1(h), subsection 15-5(1), section 15-10, section 15-15 and section 15-20, subsections 17-1(1) and (2), paragraphs 17-1(3)(a) to (c), subsection 17-1(5), subsection 17-5(1), paragraph 17-5(2)(a), paragraph 17-5(2)(c), subsection 17-5(3), subsections 17-5(4) and (6), section 17-10 (heading), subsection 17-10(1), subsection 17-10(2), paragraph 17-10(2)(a), section 17-15, section 17-20, subsections 17-25(1) and (2), section 21-1, subsections 21-5(1), (2) and (4), subsections 21-5(4) to (6), subsections 21-10(1) to (4), subsection 21-20(1), section 21-25***

(heading), subsections 21-25(1) to (3), paragraph 21-25(3)(a), subsections 21-30(1) and (2), Part 4 (heading), Division 25 (heading), section 25-1, section 25-5 (heading), subsections 25-5(1) to (6), section 25-10 (heading), subsections 25-10(1) to (6), subsection 25-15 (heading), subsection 25-15(1) to (5), subsection 25-25(5) and (6), section 29-1, subsections 29-5(1) and (2), subsections 29-10(1) and (2), subsections 29-10(4) to (6), paragraph 29-10(6)(b), subsection 29-10(8), paragraph 29-10(8)(a), subsections 29-15(1) and subsections 33-1(1), (2) and (3), section 33-5 (heading), section 33-5, paragraphs 33-5(a), (c) and (d) of the VC Act.]

Closure of the PDF regime

8.83 The PDF regime is closed to new applications for registrations as a PDF from the date of Royal Assent of this Bill. ***[Schedule 8, items 348 and 349, subsection 4(1) at the end of the definition of 'registration applications' and subsection 11(4A) of the PDF Act]***

Technical amendment

Conditional registration

8.84 Amendments are made to ensure that eligible partners in conditionally registered VCLPs and AFOFs that become fully registered are entitled to a tax exemption on the profits and gains derived from investments made while the partnership was conditionally registered.

8.85 Section 13-5 of the VC Act provides that the VCR Board may conditionally register a partnership as a VCLP or an AFOF if the partnership does not meet all the information requirements for full registration. Once full registration has been granted, the date of effect of the registration is backdated (section 13-10 of the VC Act):

- for the purposes of the tax concessions provided under the ITAA 1997, the registration is taken to have come into force on the day on which conditional registration was granted; and
- for the purposes of the VC Act and the ITAA 1936, registration is taken to have come into force on either:
  - the day on which the partnership was established if the partnership has only carried on activities relating to being registered as a VCLP or an AFOF; or
  - the day on which conditional registration was granted in all other cases.

[Schedule 8, item 350, section 118-400 (note) of the ITAA 1997; items 352 and 353, section 7-1 (note) and subsection 13-10(2) of the VC Act]

8.86The definition of 'unconditionally registered' in subsection 995-1(1) of the ITAA 1997 is amended to reflect the amendments to subsection 13-10(2) of the VC Act. ***[Schedule 8, item 351, subsection 995-1(1) definition of 'unconditionally registered']***

8.87 ESVCLPs will also be subject to this treatment. ***[Schedule 8, items 181 to 183, subsections 13-10(1) and (2), subparagraph 13-10(2)(a) and subsection 13-10(3) of the VC Act]***

Application and transitional provisions

8.88 The amendments to relax eligibility requirements (described in Part 1 above) apply to assessments for the 2007-08 income year and all later years. ***[Schedule 8, item 85]***

8.89 The amendments made to introduce an ESVCLP apply to assessments for 2007-08 income year and later years. ***[Schedule 8, item 205]***

REGULATION IMPACT STATEMENT

Background

8.90 The introduction of an ESVCLP and enhancement of the operation of the existing VCLP regime is part of an integrated package announced in the 2006-07 Budget (Treasurer's Press Release No. 37 of 9 May 2006) that was aimed at increasing activity in the venture capital sector of the private equity market.

8.91 The venture capital market in Australia currently has approximately 15 VCLPs (which reported $1,767 million in capital commitments) and approximately 15 PDFs (which have raised more than $896 million and invested more than $750 million in 546 companies up until June 2006) that are registered under current Australian Government programmes. Investors in the venture capital market include sophisticated individuals with high risk profiles and some superannuation funds that are willing to allocate some funds to riskier investments. Businesses looking for start-up or expansion capital seek venture capital interests.

8.92 The Australian Bureau of Statistics (ABS) publication *Venture Capital and Later Stage Private Equity 2005-06* (ABS Cat. No. 5678.0) states that there was a growth in funds committed to venture capital and later stage private equity investment vehicles during 2005-06 where, by 30 June 2006, investors had $10.9 billion committed to investment

vehicles, a 9 per cent increase on the previous year. It should be noted that this data is an aggregate of venture capital and later stage private equity investment as the ABS does not distinguish between the two. The industry association (AVCAL) also fails to distinguish between the two and is considered to represent the interests of private equity. No meaningful data is available on ESVCLPs from the ABS.

8.93 The number of businesses that will be affected by the proposal will be the number of venture capital funds that choose to register as ESVCLPs, which is unable to be quantified. This proposal will benefit companies that are seeking to commercialise products through increasing the pool of equity capital, stimulating the venture capital sector, and increasing competition in the venture capital sector, which should lower the cost of capital for small businesses.

8.94 As part of this package, the Government is also committing $200 million for a further round of funding of the *Innovation Investment Fund* programme. This programme provides Government funds alongside funds from private investors to encourage the development of new companies, particularly those with a technology focus. The continuation of the *Innovation Investment Fund* programme will also increase the number of fund managers with experience and expertise in the venture capital sector.

8.95 This measure is the Government's response to key findings of a review of the venture capital industry to assess the impact of recent Government reforms and the contribution of the industry to the national economy. This review was conducted by an expert group made up of persons with relevant economic and investment experience and expertise. The Minister for Industry, Tourism and Resources announced the review in a Press Release dated 10 May 2005. The Government decided not to release the expert group's Report and has not made any public announcement of the recommendations made in the report.

8.96 The Australian Government introduced the venture capital regime from 1 July 2002 and amended the regime in June 2004. The current regime is jointly regulated by the Department of Industry, Tourism and Resources and the Australian Taxation Office (ATO). The current venture capital regime makes Australia a more attractive market for investment. The Government conducted the review to allow it to comprehensively assess a number of calls from industry to make Australia an even more attractive investment destination.

Policy objective

8.97 The ESVCLP regime will provide an investment vehicle targeted at ESVCLPs providing flow-through tax treatment and a complete tax exemption for income, both revenue and capital, received by its domestic and foreign partners. The regime will progressively replace the PDF programme which provides tax concessions to investors carrying on eligible activities in eligible small and medium sized entities.

8.98 The aim of providing a tax concession to investors in ESVCLPs is to encourage venture capital investment in early stage start-up and expanding businesses with high growth potential. The flow-through limited partnership structure of an ESVCLP is more effective and relevant than the corporate structure of the PDF programme and is the internationally recognised, structure for venture capital investment. The Government previously accepted that this is the preferred, internationally recognised, structure for venture capital investment when the venture capital regime was introduced in 2002.

8.99 The aim of the changes to the VCLP regime is to encourage its use by removing unnecessary regulation and reducing its complexity without changing its intrinsic nature. Relaxing these restrictions should make Australia more competitive in attracting foreign investment in venture capital by:

- removing a range of restrictions, including allowing investment in unit trusts and convertible notes as well as shares and options;
- 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 limited partners.

8.100 The removal of restrictions will only apply for VCLPs with no additional reporting obligations to the PDF Board, which will be renamed the VCR Board. The amendment providing for ESVCLPs will have additional reporting requirements to the VCR Board. This is greater than VCLPs as it will provide significant tax benefits over the VCLP. It is not feasible to assess whether the reduction in regulation for VCLPs will outweigh the increase in reporting for ESVCLPs as they are two different investment vehicles and are not comparable.

Implementation options

Introduction of an ESVCLP

8.101 A partner in an ESVCLP will be exempt from tax on income and capital gains made on investments in entities that satisfy eligibility requirements. A tax exemption rewards profitable activities and is an incentive to select investments likely to be profitable. An alternative approach would be to grant an immediate tax deduction for investments in eligible entities. A tax concession in the form of an immediate tax benefit can be detrimental to the policy objective of a measure as, often, investors will invest merely to obtain the front end incentives. This approach is not effective in attracting investors to asset classes such as venture capital which require patient capital[1].

8.102 The structure of the ESVCLP regime is similar to that of the existing VCLP regime in that it will be a flow-through vehicle for tax purposes. However, unlike a VCLP, the ESVCLP regime:

- provides tax-exempt returns on investments to both resident and foreign partners (investors). Only certain foreign partners in a VCLP are exempt from tax on investment returns;
- restricts eligible investments to companies whose total asset value is not more than $50 million (the limit is $250 million for a VCLP); and
- requires disposal of an investment if the total asset value of a company or unit trust in which the investment is made increases to more than $250 million (no similar requirement in the VCLP regime).

8.103 The ESVCLP regime restricts the asset value of an eligible investee entity to $50 million as the regime will progressively replace the existing PDF programme which also has a $50 million asset value.

8.104 Where a disposal of an investment is required, it must be done within six months from the start of the income year. The VCR Board will monitor and enforce this requirement and where this requirement is not met, the VCR Board will revoke the ESVCLP's registration.

[1] Patient capital is not a defined term and has its ordinary meaning.

8.105 The establishment of the VCLP regime in 2002 was aimed at providing an investment vehicle for Australia that was consistent with other internationally well recognised and utilised limited partnership structures. Without such a vehicle, international capital will be discouraged from investing in any level of the Australian venture capital/private equity market. The relaxation of restrictions for VCLPs will remove unnecessary regulation and red-tape and produce an outcome that is more attuned to the way the venture capital industry operates. The availability of an internationally recognised limited partnership investment that is not overly regulated is aimed at increasing Australia's competitiveness in attracting foreign investment over and above our competitors'.

8.106 This measure is aimed at increasing levels of investment in the venture capital sector, and whilst exact quantitative data is unavailable, it is estimated that this measure will attract up to 20 per cent additional foreign and domestic investment.

8.107 Unlike VCLPs, applicants for registration as an ESVCLP will be required to submit an investment plan for approval by the VCR Board as part of the application. The VCR Board will assess these plans against specified criteria to determine whether there is an appropriate emphasis on investment in early stage venture capital. These criteria are designed to distinguish investments in businesses that are starting up, or in the early stages of expansion, from other types of investment. The VCR Board can publish guidelines (as a legislative instrument) on how it will apply the criteria.

8.108 An ESVCLP will be able to submit an amendment to a plan or a completely revised investment plan for the approval of the VCR Board. The VCR Board will assess the replacement plan against the same criteria as those used for assessing all investment plans.

8.109 ESVCLPs will be required to lodge annual and quarterly reports which will contain the same information VCLPs are currently required to provide. In addition, ESVCLPs will be required to report, on an annual basis, their performance against their investment plan, including investments and divestments. This requirement will not lead to an additional compliance cost as the reporting will generally be information that a venture capital fund prepares as part of their quarterly reporting to their investors. Typically, a venture capital fund would value its investment each quarter when reporting to its investors. In the case of an ESVCLP, it would only be required to obtain valuations on its investee entities once a year, and this information can be sourced from the audited accounts of the investee entity. The VCR Board will report in its annual report on the progress of ESVCLPs in implementing their investment plans.

8.110 The ESVCLP may incur minimal additional costs in addressing the compliance cost aspect of reporting. However, as the information required for ESVCLPs is information that it would collect in the normal running of its business (the same as VCLPs), it is expected that a venture capital fund that chooses to operate as an ESVCLP would be able to meet the reporting requirements of an ESVCLP at little or no additional cost over those related to a VCLP.

Changes to the VCLP regime

8.111 The VCLP regime provides the following tax incentives:

- a tax exemption for certain foreign investors on the profits and gains made by a VCLP on equity investments in Australian resident companies whose assets are not more than $250 million;
- VCLPs, AFOFs and venture capital management partnerships are treated as flow-through vehicles for taxation purposes. That is, each partner is taxed on its share of income, losses and profits according to the partner's tax status; and
- a venture capital manager's share of gains made by a VCLP or an AFOF on the sale of eligible venture capital investments (the carried interest) is treated as a capital gain for taxation purposes.

8.112 The VC Act contains the administrative structure and regulatory requirements for the operation of the regime. These requirements include a registration process for VCLPs and AFOFs. The PDF Board, established by the PDF Act administers these requirements. (The name of the Board is being changed to the VCR Board to reflect its other functions as, over time, PDFs will cease to exist.)

8.113 General partners of VCLPs and AFOFs are required to furnish annual and quarterly returns to the VCR Board to enable the VCR Board to monitor their compliance with investment requirements.

8.114 The operation of the VCLP regime is to be enhanced by removing or relaxing unnecessary restrictions. These changes:

- remove restrictions on the country of residence of limited partners;
- reduce the required minimum committed capital from $20 million to $10 million;

- allow investment in unit trusts and convertible notes as well as shares and options;
- allow the appointment of auditors to investee entities to occur at the end of the financial year in which the investment is made; and
- allow up to 20 per cent of a VCLP's committed capital to be invested in companies and unit trusts that do not satisfy the residency requirements.

8.115 The changes mean that some existing partners in a VCLP or AFOF who are residents of a foreign country that did not qualify for the tax exemption will be eligible for the exemption. This is expected to increase foreign investment in the Australian venture capital market. The residency requirements of investee entities are being relaxed to allow some investment in foreign entities which will further expand investment options.

8.116 Reducing the minimum partnership capital requirement and allowing investment in investee entities that have not yet appointed an auditor will increase the range of limited partnerships and entities eligible to participate in the regime. These changes also have administrative advantages.

8.117 Expanding the type of eligible investment a VCLP can make from shares and options in companies to include convertible notes and units in unit trusts, will give fund managers a wider range of investment choices. Fund managers will be able to adopt a wider range of strategies to increase their expertise and manage a higher degree of risk should they so desire.

Assessment of impacts

Impact group identification

8.118 This measure will impact on:

- small and medium businesses seeking capital injections to finance the future activities of relatively high risk and expanding businesses;

- Australian resident investors — they will be tax-exempt on income and profits and capital gains made by ESVCLPs in which they are partners;

- fund managers of ESVCLPs — they will be entitled to the carried interest tax concession which will be exempt from tax; and

- fund managers of VCLPs — they will have more investment choices.

Introduction of an ESVCLP

8.119 Small and medium businesses seeking capital injections to finance the future activities of relatively high risk and expanding businesses should find it easier to obtain capital.

8.120 Australian resident investors should be attracted to participate as they will be tax-exempt on income and profits and capital gains made by ESVCLPs in which they are partners.

8.121 The impact on foreign investors is expected to be minimal as they are not subject to Australian tax on their capital gains.

8.122 Fund managers will be required to report to the VCR Board on implementation of investment plans, including investments and divestments. These reports will be published in the VCR Board's annual report which is publicly available.

Changes to the VCLP regime

8.123 Existing limited partners in a VCLP or AFOF who are residents of a foreign country that did not qualify for the tax exemption will be eligible for the exemption. Removing this restriction should increase foreign investment in the Australian venture capital industry.

8.124 The range of limited partnerships eligible for registration as VCLPs will be expanded as the required level of committed capital has been reduced from $20 million to $10 million. This reduction in size should attract more fund managers to the VCLP regime.

Analysis of costs / benefits

Compliance costs

8.125 The overall compliance cost impact of the proposal will result in a small increase for implementation and ongoing compliance costs. The impact is expected to mainly affect a small number of small and medium enterprise clients. The impact upon tax agents and other intermediaries was considered to be minimal. The overall compliance cost impact of the proposal will result in an approximate $25,000 impact for implementation costs and a $5,000 impact for ongoing compliance costs. This impacts upon the entire industry and, given the size of committed capital, these impacts are relatively small.

8.126 There will be compliance costs for resident taxpayers seeking to take advantage of the tax exemption on income and capital gains made by an ESVCLP. However, the tax benefits that will accrue to resident partners on their returns from investments in an ESVCLP should compensate for this increase.

8.127 A small increase in compliance costs may also arise for venture capital fund managers (general partners typically structured as limited partnerships) owing to the need to acquaint themselves with ESVCLPs and the changes to VCLPs. However, these costs should be low as the ESVCLP regime is similar to the VCLP regime in most aspects and the approved investment plan requirement is similar to that currently required for the registration of a PDF. A venture capital manager's share of the gains made by a VCLP on the sale of eligible venture capital investments is called the 'carried interest'. The carried interest is treated as a capital gain which provides a tax benefit for fund managers.

Administration costs

8.128 Overall, it is anticipated that there will be minimal administrative impact on the ATO and the Department of Industry, Tourism and Resources.

8.129 As a result of this measure, the ATO may incur some minimal initial costs in making changes to its material and educating its staff, particularly about the tax exemption for resident investors in an ESVCLP. It may also incur minimal costs in providing advice to taxpayers, including through public and private rulings.

8.130 The ATO may also incur minimal additional costs in its compliance activity to ensure that resident taxpayers and fund managers are complying with the requirements of the ESVCLP regime. However, the ATO will be able to draw on its experience with the VCLP regime.

8.131 The Department of Industry, Tourism and Resources will also incur minimal initial costs in setting up the registration process for ESVCLPs, educating its staff and providing advice to fund managers. There may be a small increase in the cost of administering the VCLP regime because smaller funds will now qualify for registration and more foreign investors will qualify for the tax exemption. As with the ATO, the Department of Industry, Tourism and Resources will be able to draw on its experiences in dealing with the VCLP regime.

Government revenue

8.132 This measure will have these revenue implications:

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

Economic benefits

8.133 The Australian venture capital market plays a significant role in providing patient equity capital to start-up and expanding businesses. These amendments will stimulate activity across the venture capital sector and address the principal finding of the Government's venture capital review that the venture capital sector in Australia is underdeveloped.

8.134 A vibrant venture capital sector is important for the effective commercialisation of Australia's research and development activity and in stimulating technical innovation. It is therefore an important component of future economic growth.

8.135 These amendments should encourage domestic and foreign investment in ESVCLPs and VCLPs with the result that finance is more readily available and cheaper for relatively high risk and expanding businesses seeking to finance their innovative activities.

8.136 The amendments are an incentive for professional fund managers in other sectors to become involved in venture capital investment and for new venture capital managers to gain experience and expertise. The changes will also allow fund managers to undertake more diverse investments and spread risk.

8.137 Investors in ESVCLPs will benefit from higher returns on investments as returns will be fully tax-exempt. The ESVCLP investment vehicle replaces the PDF which was subject to tax (at concessional rates) although investors were exempt from tax.

8.138 The changes to the VCLP regime will benefit foreign limited partners who are residents of countries that were not previously eligible for the tax exemption. These limited partners will be exempt from tax on their share of profits on eligible investments made by the VCLP.

Consultation

8.139 In conducting the review, the expert group received submissions from interested parties and met with a wide range of industry stakeholders. As noted in the background, the Government decided not to release the expert group's Report and has not made any public announcement of the recommendations made in the report. It is therefore not possible to outline the views of industry.

8.140 This measure is the Government's response to key findings of the review of the venture capital industry. This measure is supported by industry as it represents industry submissions made to the review.

8.141 Targeted confidential consultation with interested parties was undertaken on the development and drafting of the legislation. This included the PDF Board, the Australian Venture Capital and Private Equity Association and the ATO.

Conclusion and recommended option

8.142 A tax exemption on income and capital gains made on investments in start-up and expanding businesses is an effective mechanism for increasing activity in the venture capital sector. It attracts patient investors aiming at identifying businesses engaged in innovative activities which are likely to have a successful outcome.

8.143 Establishing a specific vehicle for investment in start-up and expanding businesses is an incentive for more fund managers to participate in the venture capital industry. Similarly, reducing the minimum size of a VCLP is also an opportunity for fund managers to acquire experience and expertise in the venture capital industry.

8.144 Relaxing the existing restrictions on the foreign investors in VCLPs that qualify for the tax exemption and the kinds of investments that are eligible for the concession should increase foreign investment in venture capital to the benefit of the Australian economy.

8.145 While access to the benefits of these amendments will necessarily result in some increase in compliance costs for investors

seeking to take advantage of the tax incentives, these small costs will be outweighed by the tax benefits.

8.146 Treasury and the ATO will monitor this taxation measure, as part of the taxation system, on an ongoing basis.

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Schedule 1: Effective life provisions

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Items 1 and 4, subsection 26-47(5) and section 118-80	2.22
Items 2 and 3, subsections 110-38(5) and 110-55(9E)	2.23
Item 5, paragraph 69-5(3)(e) of the *A New Tax System (Goods and Services Tax) Act 1999*	2.31
Item 6, item in the table relating to boats in section 12-5	2.29
Items 7 to 17, paragraphs 25-50(1)(a), (b) to (g) and 26-50(7)(a), subsections 25-50(1) and (5) to (7)	2.30
Item 18	2.28

Schedule 3: Research and development

Bill reference	***Paragraph number***
Item 1	3.11
Item 2	3.8
Items 3 and 22	3.7
Item 4	3.17
Item 5	3.9
Item 6	3.19
Items 7 and 8	3.10
Item 9	3.20
Items 10 and 15	3.14
Items 11 and 16	3.24
Items 12 and 13	3.13
Item 14	3.23
Item 17	3.15
Item 18	3.25
Item 19	3.12
Item 20	3.22
Item 21	3.16

Schedule 4: Donation of listed shares to deductible gift recipients

Bill reference	***Paragraph number***
Items 1 to 6, subsection 30-15(2), items 1 and 2 in the table	4.8
Items 1, 4 and 7, subsection 30-15(2), items 1, 2 and 7 in the table	4.10, 4.12, 4.14, 4.16
Items 7 and 9, subsection 30-15(2), item 7 in the table	4.18
Item 8, subsection 30-15(2), item 7 in the table	4.19
Item 10	4.20

Schedule 5: Specifically listed deductible gift recipients

Bill reference	***Paragraph number***
Item 1	5.9, 5.10
Items 1 and 3 to 6	5.13

Items 2, 7 and 8	5.11, 5.12
Items 3 and 5	5.7
Items 3 to 6	5.6
Items 4 and 6	5.8

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

Bill reference	*Paragraph number*
Items 1 to 9, subsection 30-15(2), items 7 and 8 in the table	6.8
Item 10	6.10

Schedule 7: Technical corrections

Bill reference	*Paragraph number*
Item 1, paragraph 272-100(d) in Schedule 2F to the ITAA 1936	7.13
Item 2, paragraph 58-5(2)(a) of the ITAA 1997	7.16
Items 3 to 9 and 11 to 13, subparagraph 58-10(2)(b)(i), paragraphs 58-5(4)(a) and (b), 58-5(5)(a), 58-10(1)(a), 58-10(2)(a) and (c) and 58-85(1)(a) and subsection 58-10(1) of the ITAA 1997	7.29
Items 7 to 11, subparagraphs 58-10(2)(b)(i) to (iii), and paragraphs 58-10(1)(a), (2)(a) and (2)(c)	7.17
Item 14, subsection 995-1(1) of the ITAA 1997, definition of ‘exempt entity’	7.9
Item 15, and subclause 2(1), item 5 in the table	7.20
Item 16, and subclause 2(1), item 5 in the table	7.20

Schedule 8: Venture capital

Bill reference	Paragraph number
Items 1, 6, 16, 18, 26, 39, 41, 42 and 47 to 53, section 118-400, subsections 118-405(4) to (7), subsections 118-410(5) and (6), subsections 118-415(4) to (6), section 118-425 (heading), paragraph 118-435(2)(b), paragraph 118-425(11)(b), subparagraph 118-425(11)(c)(iii), paragraph 118-425(11)(d), paragraphs 118-435(1)(b) to (d), paragraphs 118-435(2)(c) and (d), subsection 118-440(1) (note) and subsection 995-1(1) (definition of 'eligible venture capital investment') of the ITAA 1997	8.17
Items 15, 17, 24 to 27, 38 and 40, subsection 118-410(4) (heading), subsection 118-415(3) (heading), subsection 118-425(9), paragraph 118-425(11)(a), subparagraph 118-425(11)(c)(i) and subsection 118-425(15A)	8.14
Items 19 to 25, paragraph 118-420(1)(c), paragraph 118-420(3)(b), paragraphs 118-420(4)(a) and (b), paragraphs 118-420(5)(b) and (c) and subsection 118-420(6)	8.23
Items 27 to 29 and 34, paragraph 118-425(1)(b) and subparagraphs 118-425(1)(b)(ii) and (iii) and subsection 118-425(9) of the ITAA 1997	8.12
Items 30 and 43, subsection 118-425(2) and subsection 118-425(12A) of the ITAA 1997	8.20
Items 31 to 33, subsection 118-425(5), paragraphs 118-425(5)(a) and (b) and subsection 118-425(5) (note) of the ITAA 1997	8.25
Items 35 to 37, subsection 118-425(10) (heading) and subsection 118-425(10) of the ITAA 1997	8.21
Items 38 and 40, paragraph 118-425(11)(a) and subparagraphs 118-425(11)(c)(i) and (ia)	8.13
Item 44, section 118-427 of the ITAA 1997	8.15
Items 44 to 46, paragraph 118-427(1)(a), paragraphs 118-430(a) and (b) of the ITAA 1997	8.15
Item 44, paragraph 118-427(1)(b) of the ITAA 1997	8.15
Item 44, paragraph 118-427(1)(c), subsections 118-427(3) and (13) of the ITAA 1997	8.15
Item 44, paragraph 118-427(1)(c) and subsections 118-427(4) and (14) of the ITAA 1997	8.15
Item 44, paragraph 118-427(1)(c) and subsection 118-427(5) of the ITAA 1997	8.15
Item 44, paragraph 118-427(1)(c) and subsection 118-427(6) of the ITAA 1997	8.15
Item 44, paragraph 118-427(1)(d) and subsection 118-427(2) of the ITAA 1997	8.15

Bill reference	Paragraph number
Item 44, paragraph 118-427(1)(c) and subsection 118-427(8) of the ITAA 1997	8.15
Items 44, 52 and 131 to 138, paragraph 118-427(1)(c), subsection 118-427(7), subsection 118-440(1) (note), subsection 118-440(1), subsections 118-440(3) and (5), paragraphs 118-440(5)(a) and (b), paragraphs 118-440(7)(a) and (c), subsections 118-440(8) and (9) of the ITAA 1997	8.15
Item 44, subsection 118-427(6) of the ITAA 1997	8.26
Item 44, subsection 118-427(9) of the ITAA 1997	8.15
Item 44, subsection 118-427(12) of the ITAA 1997	8.16
Item 54, paragraph 9-1(1)(a) of the VC Act	8.24
Item 54, paragraph 9-1(1)(d) of the VC Act	8.27
Items 56 to 84, paragraph 9-1(1)(e), subparagraphs 9-1(1)(e)(ii) and (iii), paragraph 9-1(1)(f), subparagraphs 9-5(1)(d)(ii) to (iv), paragraph 9-5(1)(e), paragraph 9-10(1)(aa), paragraph 15-1(ga), paragraph 15-1(gb), paragraphs 15-10(c), to (f), paragraph 21-5(3)(d), paragraph 21-5(3)(f), paragraph 21-20(1)(g), paragraph 21-20(1)(h), paragraph 21-20(1)(j), paragraph 21-20(1)(k), paragraph 21-20(1)(l), section 25-1, section 25-1 (note), subsections 25-5(1A) and (2), subsections 25-10(1A) and (2), subsections 25-15(1A) and (2) of the VC Act	8.18
Item 85	8.88
Items 86, 87 and 95, subsection 6(1), subsections 18A(1) and (2) and subparagraph 128B(3)(h)(ii) of the ITAA 1936; items 96 to 99, 104, 116, 120 to 129, 151 to 153, 155 and 156, subsection 4-10(2) (note 2), subsection 9-5(2) (note 2), section 11-15 (item in the table dealing with foreign investment) and section 11-15, section 36-25, section 118-400, subsection 118-410(1) (heading), paragraphs 118-410(1)(b) and (f), subparagraph 118-410(1)(f)(iv), paragraphs 118-410(2)(b) and (d), paragraphs 118-420(4)(c) and (5)(d), paragraphs 118-425(8)(b) and (11)(a), subsection 995-1(1) (after paragraph (a) of the definition of 'investment registration requirement'), subsection 995-1(1) (paragraph (b) of the definition of 'limited partnership'), and subsection 995-1(1) (definition of 'unconditionally registered') of the ITAA 1997	8.55
Item 88, paragraphs 92(2AA)(b) and 92A(1)(b) of the ITAA 1936	8.43
Items 89 to 94, subsection 94D(2), subsection 94D(2) (notes 1 to 3), paragraph 94D(3)(a) and subparagraph 94D(3)(a)(ia) of the ITAA 1936	8.42
Items 100 to 103, subsection 26-68(1) (heading), paragraphs 26-68(1)(a) and (b) and subparagraph 26-68(2)(a)(ii) of the ITAA 1997	8.51
Item 105, paragraph 51-52(1)(a) of the ITAA 1997	8.48

Bill reference	***Paragraph number***
Item 105, paragraphs 51-52(1)(b) and (d) of the ITAA 1997	8.48
Item 105, paragraph 51-52(1)(c) of the ITAA 1997	8.48
Item 105, paragraph 51-52(1)(e) and subsection 51-52(5) of the ITAA 1997	8.48
Item 105, subsection 51-52(3) of the ITAA 1997	8.48
Item 105, subsection 51-52(4) of the ITAA 1997	8.49
Items 105, 110 to 115, subsection 51-52(6), subsections 104-255(1), (4) and (5), paragraphs 104-255(6)(a) and (b), paragraph 116-30(5)(a) and subsection 118-21(1) of the ITAA 1997	8.53
Items 106 to 109, subsection 51-54(1) (heading), paragraphs 51-54(1)(a) and (b) and subparagraph 51-54(2)(a)(ii) of the ITAA 1997	8.50
Item 119, paragraph 118-407(1)(a) of the ITAA 1997	8.44
Item 119, paragraph 118-407(1)(b) of the ITAA 1997	8.44
Item 119, paragraph 118-407(1)(c) of the ITAA 1997	8.44
Item 119, paragraph 118-407(1)(d) of the ITAA 1997	8.44
Item 119, subsection 118-407(2) of the ITAA 1997	8.44
Item 119, subsection 118-407(3) of the ITAA 1997	8.45
Item 119, subsection 118-407(5) of the ITAA 1997	8.46
Items 119, 149 and 150, subsection 118-407(4) and subsection 995-1(1) (definitions of ‘early stage venture capital limited’ and ‘ESVCLP’) of the ITAA 1997	8.34
Item 130, paragraph 118-428(1)(a) of the ITAA 1997	8.38
Item 130, subsection 118-428(2) of the ITAA 1997	8.40
Item 130, subsection 118-428(3) of the ITAA 1997	8.41
Items 130 and 154, paragraphs 118-428(1)(b) and (c) and subsection 995-1(1) (definition of ‘pre-owned’) of the ITAA 1997	8.39
Items 131 to 138, subsections 118-440(1), (3) and (5), paragraphs 118-440(5)(a) and (b), paragraphs 118-440(7)(a) and (c), subsections 118-440(8) and (9) of the ITAA 1997	8.36
Items 139 to 144, section 195-60, section 195-65 (heading), section 195-65, section 195-70 (heading) and section 195-70 of the ITAA 1997	8.52
Item 145, subsection 995-1(1) (definition of ‘additional investment’ requirement for ESVCLPs)	8.37
Item 147, subsection 995-1(1) (paragraph (a) of the definition of ‘carried interest’) of the ITAA 1997	8.54
Item 148, definition of ‘divesture registration requirement’ in subsection 995-1(1) of the ITAA 1997	8.47

Bill reference	***Paragraph number***
Items 157 to 165, subsection 4(1), paragraph 6(3)(a), paragraph 6(3)(ab), paragraph 72(1)(c), paragraph 72(1)(ca), paragraph 73(1)(c), paragraph 73(1)(ca), paragraph 74(2)(c) and paragraph 74(2)(ca) of the Pooled Development Funds Act 1992 (PDF Act)	8.80
Items 166, 167, 168, 172, 173 and 174, section 3-5 (heading), paragraph 3-5(a), Part 2 (heading), subparagraph 9-5(1)(d)(i) and (ii) and paragraph 9-5(1)(e) of the VC Act	8.79
Items 169 and 170, section 7-1 of the VC Act	8.54
Item 171, paragraph 9-3(1)(a) of the VC Act	8.58
Item 171, paragraph 9-3(1)(b) of the VC Act	8.58
Item 171, paragraph 9-3(1)(c) of the VC Act	8.58
Item 171, paragraph 9-3(1)(d) of the VC Act	8.58
Item 171, paragraph 9-3(1)(e), subsections 9-3(4) and (5) of the VC Act	8.59
Item 171, paragraph 9-3(1)(f) of the VC Act	8.59
Item 171, paragraphs 9-3(1)(g) and (h) of the VC Act	8.59
Item 171, paragraph 9-3(1)(i) and subsection 9-3(6) of the VC Act	8.60
Item 171, paragraph 9-3(1)(j) of the VC Act	8.59
Item 171, paragraph 9-3(1)(k) of the VC Act	8.59
Item 171, subsection 9-3(2) of the VC Act	8.59
Item 171, subsection 9-3(3) of the VC Act	8.60
Items 175 and 176, subsection 11-1(1) and paragraph 11-1(2)(ja) of the VC Act	8.61
Item 177, subsection 13-1(1A) of the VC Act	8.62
Item 177, paragraphs 13-1(1A)(g) and (h) of the VC Act	8.63
Item 178, subsections 13-1(3) and (4) of the VC Act	8.64
Item 179, subsection 13-1(5) of the VC Act	8.65
Items 180, 181 and 182, subsections 13-5(1A) and (3) of the VC Act	8.66
Items 181 to 183, subsections 13-10(1) and (2), paragraph 13-10(2)(a) and subsection 13-10(3) of the VC Act	8.67
Items 181 to 183, subsections 13-10(1) and (2), paragraph 13-10(2)(a) and subsection 13-10(3) of the VC Act	8.87
Item 184, section 13-15 of the VC Act	8.69
Item 184, subsection 13-20(1) of the VC Act	8.70
Item 184, subsection 13-20(2) of the VC Act	8.71
Item 184, subsection 13-20(3) of the VC Act	8.72
Items 185 to 187, section 15-1, paragraph 15-1(fa) and	8.73

Bill reference	***Paragraph number***
section 15-10 of the VC Act	
Item 188, section 15-17 of the VC Act	8.74
Items 189 to 191 and 193 to 199, paragraph 17-1(1)(a), subsections 17-1(1) and (5), paragraph 17-5(1)(ab), subsections 17-5(1) and (6), subsection 17-10(1), subparagraph 17-10(1)(e)(i), section 17-15 and subsections 17-25(1) and 25-5(1) of the VC Act	8.75
Item 192, section 17-3 of the VC Act	8.76
Items 200 and 201, subsections 25-10(1) and 25-15(1) of the VC Act	8.77
Items 202 to 204, paragraphs 29-1(aa), (b) and (c) of the VC Act	8.78
Item 205	8.89
Items 206 to 214, paragraph 118-425(2)(b), subsection 118-425(2), subsection 118-425(3) (note 3), subsection 118-425(14) (heading), subsection 118-425(14), subsection 995-1(1) (definition of 'form approved' by the PDF Board), and subsection 995-1(1) (definition of PDF Board) of the ITAA 1997. Schedule 8, items 218 to 347, subsection 1-15(2), section 3-1 (note), paragraph 3-5(c), section 3-15 (heading), section 3-15, section 3-20, section 7-1, paragraph 9-10(1)(b), subsections 9-10(2) and (3), subsection 11-1(1), paragraph 11-1(2)(l), subsection 11-5(1), section 11-10, subsections 11-15(1) to (4), subsection 113-1(1), paragraph 113-1(1)(d), subsection 13-1(2), paragraph 13-1(2)(d), subsection 13-1(3), subsection 13-1(4), subsection 13-5(1) and (2), section 15-1, paragraph 15-1(h), subsection 15-5(1), section 15-10, section 15-15 and section 15-20, subsections 17-1(1) and (2), paragraphs 17-1(3)(a) to (c), subsection 17-1(5), subsection 17-5(1), paragraph 17-5(2)(a), paragraph 17-5(2)(c), subsection 17-5(3), subsections 17-5(4) and (6), section 17-10 (heading), subsection 17 10(1), subsection 17-10(2), paragraph 17-10(2)(a), section 17-15, section 17-15, section 17-20, subsections 17-25(1) and (2), section 21-1, subsections 21-5(1), (2) and (4), subsections 21-5(4) to (6), subsections 21-10(1) to (4), subsection 21-20(1), section 21-25 (heading), subsections 21-25(1) to (3), paragraph 21-25(3)(a), subsections 21-30(1) and (2), Part 4 (heading), Division 25 (heading), section 25-1, section 25-5 (heading), subsections 25-5(1) to (6), section 25-10 (heading), subsections 25-10(1) to (6), subsection 25-15 (heading), subsection 25-15(1) to (5), subsection 25-25(5) and (6), section 29-1, subsections 29-5(1) and (2), subsections 29-10(1) and (2), subsections 29-10(4) to (6), paragraph 29-10(6)(b), subsection 29-10(8), paragraph 29-10(8)(a), subsections 29-15(1) and 33-1(1), (2) and (3), section 33-5 (heading), section 33-5, paragraphs 33-5(a), (c) and (d) of the VC Act.	8.82

Bill reference	***Paragraph number***
Items 215, 216 and 217, subsection 4(1) (definition of ‘Board’), Part 2 (heading) and section 5 of the PDF Act	8.81
Items 348 and 349, subsection 4(1) at the end of the definition of ‘registration applications’ and subsection 11(4A) of the PDF Act	8.83
Item 350, section 118-400 (note) of the ITAA 1997; items 352 and 353, section 7-1 (note) and subsection 13-10(2) of the VC Act	8.85
Item 351, subsection 995-1(1) definition of ‘unconditionally registered’	8.86