Law Council
OF AUSTRALIA

Business Law Section

Capital gains tax reforms—arrangements for innovative start-ups

Treasury

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Introduction

1. The Taxation Committee of the Business Law Section of the Law Council of Australia (the **Committee**) welcomes the opportunity to make this submission to Treasury in response to the exposure draft legislation for the Innovative Business CGT Concession (**IBCC**), comprising the Treasury Laws Amendment (Tax Reform No. 5) Bill 2026: Innovative Business CGT Concession (**Exposure Draft Bill**), the accompanying Explanatory Memorandum (**Explanatory Memorandum**), and the Income Tax Legislation (Innovative Company Test—Conditions for Existing Startups) Determination 2026 (**Legislative Instrument**), released on 11 September 2026.

2. This submission follows the Law Council's earlier submission of 17 July 2026 to Treasury in response to the consultation paper, Capital gains tax reforms—arrangements for innovative start-ups (**Consultation Paper**), released on 18 June 2026. The Law Council's earlier submission raised a number of concerns regarding the proposed design of the concession and made recommendations directed towards ensuring that the IBCC would operate coherently within the existing tax framework. This submission responds to the manner in which those issues have been addressed in the exposure draft legislation and identifies areas where the Committee considers further refinement is required.

3. The Committee commends the policy objective of ensuring that the Australian tax system continues to support innovation, entrepreneurship, employee ownership, and long-term productive investment. The Committee acknowledges that the exposure draft legislation addresses a number of matters raised in its earlier submission and in submissions made by other stakeholders. In particular, the Committee welcomes the reduction of the minimum holding period from five years to three years, the introduction of a registration and certification framework for IBCC companies, and the inclusion of employee share trust interests within the scope of IBCC assets. The central proposition of this submission is that the IBCC should be judged not by the theoretical availability of a concession but by whether it will, in practice, promote the establishment, financing and development of innovative Australian businesses. The regime should be assessed from the perspective of founders, investors, and employees at the time they make the economic decisions the concession is intended to influence.

4. This submission should be read together with the Committee's earlier submission on the Consultation Paper and its submission of 9 June 2026 to the Senate Economics Legislation Committee in relation to the Treasury Laws Amendment (Tax Reform No. 1) Bill 2026 and related measures. That earlier submission raised broader concerns about the design, completeness, and implementation of the capital gains tax reforms. Those concerns remain directly relevant to the IBCC because the concession is not a standalone measure. It is a targeted exception to a broader reform enacted by the Treasury Laws Amendment (Tax Reform No. 1) Act 2026 and the Income Tax Rates Amendment (Tax Reform No. 1) Act 2026, which received Royal Assent on 26 June 2026 and apply from 1 July 2027. Those Acts replaced the 50 per cent CGT discount for individuals, trusts and partnerships with cost base indexation; introduced a 30 per cent minimum tax on capital gains under Division 119 of the ITAA 1997, with an exemption for recipients of certain government payments;

applied the new arrangements prospectively to gains accruing on and after 1 July 2027, including gains on pre-CGT assets; retained the CGT discount for new and affordable housing; and maintained the existing small business CGT concessions.

Recommendations

The Committee recommends that Treasury:

- **provide that registration under section 115-165 operates as an optional administrative safe harbour, with its limited evidentiary effect stated expressly, rather than as a mandatory precondition to accessing the concession. Company-status and disqualified-asset rulings should remain available under Division 363 of Schedule 1 to the *Taxation Administration Act 1953*, with the Commissioner able to rule on remaining tax and asset-level issues under the ordinary ruling framework. A Division 363 ruling binds the regulators only where it applies to the entity and the entity relies on it (section 363-65). A company and its investors should remain able to establish entitlement by demonstrating that the substantive statutory conditions are satisfied without registration;**

- **simplify the innovative company test in subsection 115-155(2) so that growth potential, scalability, broader market access, and competitive advantage operate as relevant factors or statutory safe harbours rather than cumulative gateways;**

- **remove or materially simplify the predominant activity test in proposed subsection 115-155(5), which imposes an unnecessary second innovation test after the company has satisfied the innovative company test;**

- **narrow the excluded activities in subsection 115-155(6) so that innovation within established industries such as financial services and insurance is not excluded merely because the business performs the underlying service, provided the product, service, process or business model is genuinely innovative;**

- **provide specific protection for genuine founder interests issued during the formative period of the business, including where the company subsequently demonstrates within an appropriate period that it satisfies the innovation criteria;**

- **ensure that company-level administrative failures, including failure to lodge annual reports and cancellation of registration, do not retrospectively prejudice investors, employees and minority shareholders who had no control over and no knowledge of the relevant failure; and**

- **provide that the three-year holding period distinguishes voluntary early realisations from compulsory or involuntary disposals, including an exception where an employee is required to dispose of interests under the employee share scheme or associated arrangements as a consequence of cessation of employment.**

- **ensure that the employee share scheme start-up concession in section 83A-33 of the ITAA 1997 operates as an independent, standalone route to discounted capital gains tax treatment, without requiring satisfaction of the separate innovation conditions under the IBCC, or alternatively apply an express no-worse-off principle so that overlapping requirements are not cumulative and the more favourable and less onerous standard applies;**

- **retain the reduction of the minimum holding period from five years to three years and the registration and certification framework for IBCC companies;**

- **further expand the scope of the concession beyond early-stage investment to support the full innovation funding lifecycle, including by increasing the $50 million turnover threshold and reconsidering the 15-year age limit;**

- **remove the affiliate limb of the 15-year requirement, determine that requirement by reference to the company undertaking the innovative business, replace the broad rule with a targeted integrity provision addressing a newly incorporated company that substantially acquires, continues or carries on a pre-existing business of an older entity or arrangements that artificially obtain a fresh eligibility period, and, if an affiliate rule is retained, provide a clear statutory safe harbour so that affiliate status alone does not disqualify a genuinely new innovative business;**

- **clarify the interaction between the IBCC and employee share scheme rules under Division 83A of the ITAA 1997, including by ensuring that the multi-event architecture of the ESS regime is coherently accommodated and that eligibility is tested at grant for employee options and rights;**

- **broaden the transitional safe harbours for existing ventures, including by deeming existing ESIC companies and start-up ESS interests to satisfy the innovation test and allowing the turnover test to be applied at the time of share issue;**

- **expand the innovation testing framework under the Legislative Instrument with additional objective safe harbour pathways and extend the instrument to apply to new companies incorporated on or after 1 July 2027;**

- **not introduce a lifetime cap on the total capital gain eligible for the IBCC discount in the final legislation;**

- **expand the continuity rules for rollovers and restructures in proposed subsection 115-150(6) to include a targeted test for whether the holder's economic interest is substantially maintained, including in Division 122 transfers and Subdivision 124-M scrip-for-scrip rollovers, and confirm the treatment of Division 615 restructures;**

- **clarify the venture capital fund tracing rules and provide specific guidance on mixed portfolios and waterfall distribution arrangements; and**

- **ensure the registration and ruling framework under section 115-165 and Subdivisions 115-BB and 115-BC of the ITAA 1997 and Division 363 of Schedule 1 to the Taxation Administration Act 1953 is adequately resourced, recognising that a Division 363 ruling binds the Commissioner and the Industry Secretary only where it applies to an entity and the entity relies on it (section 363-65).**

1. Policy context: the broader capital gains tax changes create a particular problem for start-ups

The IBCC should not be considered in isolation

5. The IBCC operates against the background of the most significant change to Australia's capital gains tax regime in over two decades. The Treasury Laws Amendment (Tax Reform No. 1) Act 2026 and the Income Tax Rates Amendment (Tax Reform No. 1) Act 2026 received Royal Assent on 26 June 2026 and apply from 1 July 2027. Those Acts replaced the 50 per cent CGT discount for individuals, trusts and partnerships with cost base indexation; introduced a 30 per cent minimum tax on capital gains under Division 119 of the ITAA 1997, with an exemption for recipients of certain government payments; applied the new arrangements prospectively to gains accruing on and after 1 July 2027, including gains on pre-CGT assets; retained the CGT discount for new and affordable housing; and maintained the existing small business CGT concessions. The reform fundamentally changes the taxation of long-term capital growth, including growth arising from entrepreneurial effort, employee participation, and venture-backed risk capital. Under subsection 115-145(1) of the ITAA 1997 and paragraph 1.18 of the Explanatory Memorandum, gains to which the IBCC discount applies are not subject to the minimum tax under Division 119 and are not subject to the deemed disposal and reacquisition in sections 112-155 and 112-165. A taxpayer who instead chooses cost base indexation is subject to both.

6. The Committee's concern, as expressed in its earlier submission on the Consultation Paper, is that the IBCC is being designed as a narrow exception to a broader regime that remains incomplete. The issues identified in this submission must be resolved as part of the design of the IBCC and should not be deferred to later guidance or subsequent legislative tranches.

7. The Consultation Paper noted that the IBCC sits alongside the increase in the turnover threshold from $2 million to $10 million for certain small business CGT concessions. While the Committee welcomes that increase, the practical expansion of eligibility is more limited than may appear. As the Law Council explained in its earlier submission, on a 15 per cent EBIT margin and 4.0x EBIT multiple, a business with $10 million of turnover would have an implied enterprise value of $6 million, which is at the boundary of the existing $6 million maximum net asset value test. The amendment therefore primarily benefits businesses with turnover between $2 million and $10 million whose net assets exceed $6 million, rather than creating a wholly new class of eligible taxpayers.

8. In this context, the Committee considers that it is particularly important that the IBCC appropriately support investment in innovative start-ups through the full lifecycle of those businesses.

Innovation requires both financial capital and human capital

9. The Committee reiterates its view that innovation policy must recognise two distinct but equally important forms of capital. First, innovative businesses require financial capital, provided by founders, angel investors, venture capital funds, private capital funds, and strategic investors. Secondly, innovative businesses require human capital, provided by founders, employees and management teams who accept below-market cash remuneration, career risk, and illiquidity in exchange for equity participation.

10. A tax regime that supports venture capital investment but weakens employee equity incentives would be incomplete. Financial capital and human capital are complementary, and both are required for a functioning innovation ecosystem. The start-up employee share scheme concession in section 83A-33 of the ITAA 1997 has been a central part of the regime for attracting, retaining and motivating human capital. The exposure draft legislation must ensure that both forms of capital are coherently supported.

The innovation economy extends beyond early-stage start-ups

11. The Committee reiterates its view that the innovation economy extends beyond early-stage start-ups. Innovative companies commonly require capital at multiple stages: pre-seed investment, angel investment, seed funding, Series A and later venture rounds, and growth equity. The age and turnover thresholds in proposed section 115-155 limit the IBCC to the early part of this lifecycle. The Committee considers that this creates a material policy gap.

12. The proposed framework may also inadvertently favour certain forms of innovation over others. Companies developing software products may achieve commercial returns within a few years, whereas companies in biotechnology, clean energy, advanced manufacturing, and deep technology may require significantly longer development periods and greater capital investment before reaching market. A concession designed around the software start-up model may not adequately support innovation in these sectors, which are of strategic importance to Australia.

13. The Committee recommends that the concession be designed to support the full innovation funding lifecycle, including by providing graduated or extended eligibility for companies in sectors with longer development cycles, and by ensuring that the concession does not create incentives for capital to rotate towards lower-risk and more liquid investments at the expense of long-term, capital-intensive innovation.

2. The exposure draft does not respond adequately to concerns raised in the earlier consultation

14. The exposure draft does not respond adequately to the concerns raised in the Law Council's earlier submission on the Consultation Paper. Rather than reducing the number of gateways which must be satisfied, the draft combines a detailed innovative company test with a separate predominant activity test, an issue-time requirement, a direct-issue requirement, a minimum holding period, mandatory registration, annual reporting, suspension and cancellation consequences, and a continuing risk that existing assets will become disqualified. The cumulative effect of these conditions must be considered as a whole. A regime of this complexity is difficult to reconcile with the Section's guiding principles of delivering certainty, predictability and fairness, and of advocating for the modernisation, simplification and harmonisation of business law.

3. The regime risks becoming an administrative eligibility system rather than an investment incentive

15. The regime risks becoming more concerned with defining, testing, registering and continually monitoring eligibility than with encouraging the investment which prompted the concession. An effective incentive must be accessible, navigable and intelligible to the persons it is intended to influence. The concession should be assessed from the perspective of a founder deciding whether to establish a business, an investor deciding whether to commit capital, and an employee deciding whether to accept equity. A nominally generous concession will not promote investment if its availability cannot be determined with reasonable confidence at those decision points. As the Law Council explained in its 17 July 2026 submission, certainty is required when equity is issued, not only years later when an asset is realised.

4. Start-up status and innovation should be separate concepts

16. The legislation should clearly distinguish two conceptually different questions: (a) is the company an eligible Australian start-up, determined by objective requirements concerning age, size, listing status and Australian connection; and (b) is the business genuinely innovative, determined by a coherent principles-based test. The present structure instead layers paragraphs 115-155(1)(a) to (f), the innovative company test in subsection 115-155(2), the predominant activity test in subsection 115-155(5), and registration under paragraph 115-155(1)(i), without clearly separating those two enquiries.

17. Those successive gateways make the regime difficult to understand and apply, particularly for founders and early investors. A company should be able to establish objectively that it is an eligible start-up and separately establish, where relevant, that its business involves genuine innovation. The legislation should not make the same policy question depend on several overlapping tests operating at different times.

5. The innovative company test is too prescriptive and cumulative

18. The Committee welcomes the introduction of safe harbour conditions in the Legislative Instrument. The safe harbour approach represents a significant improvement over the purely subjective innovation testing framework proposed in the Consultation Paper and reflects the recommendations made by the Law Council and other stakeholders for objective qualification pathways.

19. The five conditions in proposed subsection 115-155(2) should not operate as cumulative gateways. A company may plainly be an innovative Australian start-up but fail because one forward-looking limb cannot yet be demonstrated. The core requirement should be that the business is established and operated for the purpose of developing and generating commercial success from genuine innovation. Growth potential, scalability, broader market potential, and competitive advantage should be relevant factors or statutory safe harbours rather than independent conditions that must all be satisfied.

The $50 million turnover threshold creates cliff-edge outcomes

20. The Committee remains concerned that the $50 million aggregated turnover threshold in proposed paragraph 115-155(1)(d), tested for the company's most recent prior income year, creates a rigid cliff-edge that is inconsistent with the principle of proportionality. An innovative company that exceeds this threshold in a single income year may be prevented from issuing further IBCC assets, even if the breach is temporary or attributable to a single contract, project, or government grant. Under paragraph 115-150(1)(d) and paragraph 1.71 of the Explanatory Memorandum, an asset issued while the company was an IBCC company is not automatically disqualified merely because the company subsequently exceeds the turnover or age limits, and paragraph 1.86 of the Explanatory Memorandum confirms that point. The asset may nevertheless become disqualified if the company ceases to satisfy the predominant activity test, its registration ceases to have effect, or a determination applies under subsection 115-160(1). The cliff-edge concern should therefore be understood principally as a concern about future equity issues rather than loss of status for existing assets.

21. The Committee notes that the $50 million threshold appears to be derived from the existing start-up ESS concession framework in section 83A-33 of the ITAA 1997, which was introduced in 2015. Since that time, innovative businesses have faced material increases in labour, software development, professional, regulatory, premises and general business costs. The threshold has not been indexed since its introduction.

22. The Committee recommends that the threshold be increased to at least $75 million, or that an averaging mechanism, grace period, or tapering provision be introduced to prevent cliff-edge outcomes. At minimum, the legislation should permit a company to test turnover by reference to an average over two or three income years, rather than a single year.

The 15-year age limit and listing disqualification

23. Proposed paragraph 115-155(1)(a) requires that the company be incorporated less than 15 years before the relevant time. Paragraph 115-155(1)(b) applies the same 15-year limit to an affiliate of the company, so the age limit cannot be avoided through a group structure. While this is a reasonable threshold for many early-stage companies, it may exclude companies in sectors where the innovation cycle is longer, such as biotechnology, deep technology, medical devices, clean energy, and advanced manufacturing. Companies in these sectors may require 10 or more years of research and development before achieving commercial returns.

24. The Committee is also concerned that the listing disqualification in proposed paragraph 115-155(1)(c) does not adequately accommodate the commercial realities of innovative businesses. A company may list on a public exchange to raise capital for innovation activities while remaining genuinely focused on developing new products or services. The listing itself should not be determinative of IBCC eligibility. The Committee recommends that consideration be given to a carve-out for companies listed on junior or innovation-focused exchanges, or for companies that list within a defined period after incorporation.

The affiliate limb of the 15-year requirement

25. The affiliate limb of the 15-year eligibility requirement in proposed paragraph 115-155(1)(b) is too broadly drafted and should be removed or substantially narrowed. Proposed section 115-155 requires a company to have been incorporated under an Australian law for less than 15 years but extends that requirement to an affiliate. The resulting rule imports the incorporation history of another entity into the eligibility of the company undertaking the innovative business.

26. The Committee recognises the legitimate integrity concern underlying this requirement. An established business should not obtain a fresh 15-year eligibility period merely by incorporating a new company and transferring an existing business into it. However, the proposed affiliate rule goes further than necessary because it focuses on the relationship between entities rather than whether an existing business has been rebadged or transferred.

27. The fundamental difficulty is that the rule uses the age of an affiliate as a proxy for the age of the innovative business. Those matters are not necessarily the same. A genuinely new innovative business may be established by, in association with, or with support from an entity operating for 15 years or more. It may involve new technology, new intellectual property, new employees, new capital, and substantially different commercial risks. Excluding that business merely because it has an older affiliate is difficult to reconcile with proposed section 115-140, which identifies encouraging early investment in innovative start-ups with growth potential as the object of the concession.

28. The affiliate limb also adds complexity and uncertainty to an already highly conditional concession. It requires companies and investors to examine relationships with other entities and their incorporation history, in addition to the company's own eligibility. This compounds the position because the Exposure Draft Bill separately uses aggregated turnover for the $50 million limitation. Different relationship-based

enquiries may therefore apply to different elements of the eligibility regime, increasing transaction costs for start-ups, investors and advisers.

29. Certainty is particularly important when capital is raised. Under proposed section 115-150, relevant shares, options, warrants and qualifying convertible notes generally need to be issued when the issuing company is an IBCC company. Eligibility cannot therefore be left until disposal. Additional due diligence and advice concerning affiliate relationships and the corporate history of other entities may be required before an investor can determine whether the concession is expected to apply. That uncertainty diminishes the effectiveness of an incentive intended to encourage early-stage risk capital.

30. The integrity concern should instead be addressed directly. The legislation should distinguish a newly incorporated company that substantially acquires, continues or carries on an existing business of an older entity from a newly incorporated company undertaking a genuinely new innovative business, notwithstanding its relationship with an established entity. The affiliate limb should be removed, and the 15-year requirement should ordinarily be determined by reference to the company undertaking the innovative business. If an affiliate rule is retained, the legislation should provide a clear, objectively ascertainable statutory safe harbour for genuinely new innovative businesses, without discretionary approval or another subjective eligibility requirement.

R&D expenditure condition thresholds

31. Section 6 of the Legislative Instrument sets conditions only for the requirement in paragraph 115-155(2)(a), being a genuine focus on developing for commercialisation new or significantly improved products, processes, services or marketing or organisational methods. A company satisfies that paragraph if it was incorporated before 1 July 2027 and meets either the R&D expenditure condition or the IP commercialisation condition. The R&D expenditure condition requires notional R&D deductions of at least 30 per cent of the company's total expenses for the most recent income year before the test time, or at least 15 per cent of total expenses over the three most recent income years before the test time, with R&D expenditure and total expenses measured by reference to sections 355-205, 355-305, 355-480, 355-520, 355-580 and 355-115 of the ITAA 1997. A company must satisfy the conditions for each of paragraphs 115-155(2)(a) to (e) before it is taken to meet the innovative company test as a whole, so the instrument does not remove the cumulative character of the test.

32. The Committee considers that the 30 per cent single-year threshold may be too high for companies in certain sectors. Software companies, for example, may have significant labour costs that are not classified as R&D expenditure under the R&D tax incentive rules in Division 355 of the ITAA 1997 but which are directly attributable to innovation activities. Similarly, companies that have reached a stage where they are commercialising the products of earlier R&D may have reduced current-year R&D expenditure but remain genuinely innovative.

33. The 15 per cent three-year average is more accessible but may still exclude companies that are genuinely innovative but have diversified expenditure profiles. The Committee recommends that the R&D expenditure thresholds be reconsidered

and that consideration be given to alternative or additional measures of innovation expenditure, including total expenditure on developing new or significantly improved products, processes, services or business models.

Additional safe harbour pathways

34. Section 7 of the Legislative Instrument sets conditions for paragraph 115-155(2)(b), high growth potential. That condition is satisfied by any one of the external investments condition, requiring at least $200,000 of equity investment in cash from wholesale or sophisticated investors who, when investing, are neither associates of the company nor associates of any shareholder; the venture capital investment condition; the employee equity incentives condition, involving an employee share scheme established with at least a 10 per cent equity allocation at establishment; the turnover growth rate condition, requiring continuous business over the three most recent income years before application for registration, turnover from commercial activities in the first of those years, and growth of at least 30 per cent over those three years; or the customer contracts condition, requiring at least three contracts with different non-associate entities involving monetary consideration and part performance. Sections 8, 9 and 10 set conditions for paragraphs 115-155(2)(c), (d) and (e) respectively, and reuse several of the section 6 and section 7 conditions.

35. The Committee considers that these safe harbour pathways are constructive but could be expanded. Several suggested pathways already appear in the draft Determination. Registered patents, certified designs and plant breeder's rights are recognised through the IP commercialisation condition in subsection 6(4) and the IP jurisdictions condition in subsection 9(6); accelerator programs are recognised through the accelerator program condition in subsection 8(2); and research collaboration with a registered research service provider, a listed higher education institution or an Australian government agency undertaking publicly funded research is recognised through subsection 10(2). The Committee recommends that Treasury extend those existing conditions and add pathways that are genuinely absent for companies that:
    - have received Commonwealth, state or territory innovation or commercialisation grants;
    - have been awarded recognised innovation or export awards;
    - hold a favourable finding under section 28C of the Industry Research and Development Act 1986 outside the three-year window in subsection 9(5).

The Legislative Instrument should apply to new companies

36. The Committee notes that the Legislative Instrument is made for the purposes of both subsection 115-155(3) of the ITAA 1997 and subsection 115-145(6) of the Income Tax (Transitional Provisions) Act 1997 and applies only to existing startups incorporated before 1 July 2027. Subsection 115-155(4) of the ITAA 1997 already empowers the Industry Secretary to determine conditions for companies that are not subject to the transitional rules. The gap is therefore one of exercise of the power rather than absence of power. The Committee recommends that the Industry Secretary make a parallel determination for companies incorporated on or after 1 July 2027 before commencement.

37. The Committee considers that this creates an asymmetry between existing and new companies and may disadvantage companies that commence operations after the commencement date. The Committee recommends that the parallel determination be made before commencement so that new companies have access to equivalent objective safe harbour conditions.

6. The predominant activity test imposes an unnecessary second innovation test

38. Proposed subsection 115-155(5) imposes a separate predominant activity test after the company has already satisfied the innovative company test. The company must conduct relevant development or commercialisation activities which are not ineligible activities and then satisfy at least two of three separate tests, each requiring more than 75 per cent concerning assets, employees, and income. The three 75 per cent measures are tested by reference to the company and each entity it controls within the meaning of section 328-125 of the ITAA 1997. The income measure is expressed by reference to total assessable income, exempt income, and non-assessable non-exempt income. This amounts to an unnecessary second innovation test and is disproportionate to the integrity objective it is said to serve. It should be removed or materially simplified.

39. Paragraph 115-155(5)(c) also requires that the company not intend to cease the relevant activity within five years after first registering and that a reasonable person in the company's position not expect it to cease that activity during that period. The only qualification is where the company becomes insolvent within the meaning of section 9 of the Corporations Act 2001. That qualification does not address commercial pivots. This is an additional forward-looking requirement inconsistent with start-up reality. Innovative businesses pivot, acquire complementary businesses or intellectual property, and change the relative composition of their assets, employees, and income as they move from development to commercialisation. A company may derive income from ancillary activities which fund the continuing development of its principal innovation. Movement across an arbitrary percentage threshold, or a change in expected activity over five years, should not determine whether investors receive the intended treatment. The Committee recommends that the predominant activity test be removed or materially simplified, with any integrity rule directed at genuinely nominal or incidental innovation rather than a second detailed gateway.

40. The exposure draft presently requires a company to satisfy both the innovative company test in proposed subsection 115-155(2) and the predominant activity test in proposed subsection 115-155(5). This confirms the concern that the predominant activity test operates as a second innovation gateway rather than as a targeted integrity rule. The Committee recommends that the predominant activity test be removed or materially simplified. If Government retains any separate activity requirement, it should not duplicate the innovative company test or require a company that has established genuine innovation through a safe harbour to satisfy a second cumulative test.

41. Any retained activity requirement should focus on whether innovation is genuine and commercially material, rather than impose separate 75 per cent thresholds and a five-year intention test. The legislation should also ensure that safe harbour qualification is not undermined by a second cumulative gateway. This would give effect to the Law Council's earlier recommendation for objective qualification pathways while avoiding the layered structure now apparent in the exposure draft.

42. The Committee notes subsection 115-160(3), which provides that a company that has engaged for at least 20 years in activities meeting the predominant activity test is taken not to have ceased to meet those requirements. Subsection 115-160(3) is expressed to apply only for the purposes of paragraph 115-160(2)(a), which concerns a disqualification determination, whereas paragraph 1.96 of the Explanatory Memorandum describes the 20-year rule as preventing interests from becoming disqualified assets generally. The Committee recommends that subsection 115-160(3) be redrafted so that it also applies for the purposes of paragraph 115-160(1)(a). Paragraph 1.96 of the Explanatory Memorandum also refers to those interests having been held for at least five years, which does not correspond to the three-year minimum holding period in subparagraph 115-150(1)(f)(i). The Explanatory Memorandum should be corrected.

7. The excluded activities are too broadly drawn

43. Proposed subsection 115-155(6) excludes a range of activities from the predominant activity test through subparagraph 115-155(5)(a)(ii). The excluded activities comprise property development or land ownership; specified finance activities, being banking, providing capital to others, leasing, factoring and securitisation; insurance; the construction or acquisition of infrastructure and related facilities; making investments directed to deriving interest, rent, dividends, royalties or lease payments; and developing technology for gambling and for tobacco and vaping goods other than for a harm minimisation purpose. Targeted exclusions may be justified on substantive public policy grounds, but that is conceptually different from excluding innovation merely because it occurs within a conventional industry.

44. Subsection 115-155(7) exempts the development of technology for use in relation to the activities in paragraphs 115-155(6)(b), (c) and (e), being specified finance activities, insurance, and passive investment. The exception does not extend to property development, infrastructure, gambling or tobacco and vaping technology. This structure creates an artificial and unprincipled distinction between developing technology for an industry and establishing an innovative business which itself provides the relevant service. A genuinely innovative financial services business may itself provide finance, and an innovative insurance business may itself conduct insurance. Innovation should not be excluded merely because the innovator operates in the industry it is disrupting. The exclusions should be narrowed so that a product, service, process, or business model that is genuinely innovative remains eligible, subject only to targeted exclusions grounded in substantive public policy. This is particularly important for FinTech and InsurTech businesses, which are a significant and growing part of Australia's innovation economy.

8. The temporal requirements are a fundamental structural problem

45. Proposed paragraph 115-150(1)(c) requires an asset to be issued on or after 1 July 2027, and proposed paragraph 115-150(1)(d) requires the asset to be issued at a time when the company is an Innovative Business Capital Gains Tax Concession company. These are not minor timing rules. Together they determine whether each particular interest can become a qualifying asset and require the company-level conditions to be considered at the point when the founder, investor or employee acquires the interest. The issue-time rules should be assessed against the commercial reality that innovation develops over time.

Original shareholders and founders

46. Founders ordinarily acquire their original shares at or around incorporation, when the company may have no operating history, employees, customers, revenue or established intellectual property. That is precisely when it may be hardest to demonstrate high growth potential, successful scalability, broader market access, and competitive advantage. The persons assuming the earliest entrepreneurial risk can therefore be the persons for whom it is hardest to establish qualification for a concession intended to encourage early investment. Genuine founder interests issued during the formative period should be protected where the company subsequently demonstrates within an appropriate period that it satisfies the relevant innovation criteria.

Angel, seed, and subsequent early-stage investors

47. Angel and seed investors may subscribe before every condition in proposed section 115-155 can be demonstrated, while later investors may subscribe after those conditions become demonstrable. The economic character of both investments may nevertheless be genuine early-stage risk capital, with the earlier investor accepting materially greater risk. The exposure draft can produce different tax treatment based only on the company's position on the respective dates of issue. The concession should support genuine risk capital from formation through seed, angel, and subsequent growth rounds rather than create an arbitrary dividing line in the financing lifecycle.

Employees acquiring interests in the formative period

48. The same concern applies to employees acquiring interests during the formative period. Earlier employees may accept the greatest career and economic risk, including below-market remuneration and illiquidity, yet face greater uncertainty because the company cannot demonstrate every forward-looking statutory characteristic. The regime should encourage employee participation from the formative stages of the business and should not provide greater certainty to an employee who joins after commercial potential has been established than to an employee who helped create that value.

Trust structures

49. The Committee also recommends that further rules be introduced to address trust structures more comprehensively. The interaction between the IBCC asset requirements and Division 6 of Part III of the Income Tax Assessment Act 1936 and Subdivision 115-C of the ITAA 1997 requires clarification. The exposure draft does address trusts to a degree, through subparagraphs 115-145(1)(c)(ii) and (iii) and subsection 115-145(3), and through subparagraph 115-150(1)(e)(ii) and subsections 115-150(3) and (4). Those provisions require the beneficiary or member to have held that status from acquisition by the trustee until the CGT event. Paragraph 1.30 of the Explanatory Memorandum records that the Government is still considering the application of the direct-issue requirement to managed investment trusts, attribution managed investment trusts and other widely held trusts. The Committee recommends that the position for widely held trusts be settled before introduction and that the continuous beneficiary requirement be addressed, as it will be difficult to satisfy for discretionary trusts and trusts with changing beneficiary classes. The legislation should clarify the operation of Subdivision 115-C and the tracing rules in paragraphs 115-145(1)(c) and (d) for successive qualifying trusts, including the treatment of beneficiaries whose interests change over time. Subsection 115-145(3) generally excludes public unit trusts but expressly includes managed investment trusts; the treatment of other widely held trusts remains under consideration in paragraph 1.30 of the Explanatory Memorandum.

9. Retrospective registration does not solve the substantive timing problem

50. The Committee recognises that retrospective registration is provided for in proposed subsection 115-155(8). However, a company may already apply for a private ruling under section 363-25 in Schedule 1 to the Taxation Administration Act 1953 before issuing equity. Under section 363-65, a ruling binds both the Industry Secretary and the Commissioner in relation to an entity only if it applies to the entity and the entity relies on it. Section 363-28 extends an applicable company ruling to an entity holding an asset issued by the company and to a beneficiary of a trust holding such an asset; the draft leaves the words **[direct or indirect]** in square brackets. The ruling does not itself establish all asset-level and holder-level conditions. Retrospective registration does not provide the same level of certainty as pre-issue registration. The remaining gap is the timeliness and cost of the ruling pathway and the need for timely, effective registration before equity is issued, rather than the absence of a pre-issue binding mechanism.

51. Although proposed subsection 115-155(8) provides retrospective treatment for registration, it applies expressly for the purposes of paragraph 115-155(1)(i), being the registration limb. Under paragraph 115-155(8)(b), the later registration must occur before the company has been incorporated for 15 years. Under paragraph 115-155(8)(d), the company must give written notice of the registration to the Industry Secretary and to each entity holding a CGT asset that is an IBCC asset issued by the company. The notice requirement may be impractical where earlier holders of qualifying interests cannot be located, and the 15-year limit removes retrospective registration for older ventures. Paragraph 115-155(8)(c) also requires the company, at the time of registration, to meet paragraphs 115-155(1)(a) to (h) as a

condition of obtaining the retrospective treatment for registration. It does not state that paragraphs 115-155(1)(a) to (h) are retrospectively deemed to have been satisfied when the earlier interest was issued.

52. That distinction is critical for founder shares, initial seed investment and interests issued to the earliest employees. Later registration should not be treated as a complete answer to the temporal problem. A separate statutory mechanism is required to protect genuine formative-stage interests where the business subsequently establishes within an appropriate period that it satisfies the substantive policy criteria.

10. Registration should not be a precondition and should operate merely as a safe harbour

53. The Committee welcomes the registration framework in proposed section 115-165, but registration is not a binding certification. Paragraph 1.92 of the Explanatory Memorandum states that registration is not alone determinative and that a company mistakenly registered which does not satisfy the other requirements is not an IBCC company. Subsection 115-168(3) also permits cancellation where the company never met a requirement in section 115-155. The Committee therefore welcomes the framework while recording that it does not deliver binding certification. The Law Council's earlier recommendation for a binding certification pathway is met, if at all, by the rulings regime under Division 363 of Schedule 1 to the Taxation Administration Act 1953. Registration should nevertheless operate as an optional administrative safe harbour rather than as a mandatory precondition to access the concession, and a company and its investors should remain able to establish entitlement by demonstrating that the substantive statutory conditions are satisfied without registration.

54. The Committee also notes a technical limitation in the registration mechanism. Proposed paragraph 115-165(1)(c) requires the Industry Secretary to be satisfied that the company meets paragraphs 115-155(1)(a) to (g); it does not expressly require satisfaction of the predominant activity test incorporated through paragraph 115-155(1)(h). Registration therefore does not, on the face of the draft, certify every substantive requirement for company status. The legislation should make clear what a registration decision establishes and should not treat registration as a complete answer to the substantive timing and qualification issues.

Binding certification should be available before share issue

55. The Committee recognises that a company may apply for a private ruling under section 363-25 in Schedule 1 to the Taxation Administration Act 1953 before issuing equity. Under section 363-65, a ruling binds both the Industry Secretary and the Commissioner only in relation to an entity to which it applies and which relies on it. Section 363-28 extends an applicable company ruling to holders of assets issued by that company and to certain trust beneficiaries, although **[direct or indirect]** remains unresolved in the draft. The remaining gap is the timeliness and cost of that pathway and the absence of an expedited process to secure effective registration before equity is issued. Section 115-165 does not expressly prevent a company from applying for and obtaining registration before an issue; subsection (2) allows the

Industry Secretary to specify when registration takes effect. The Committee recommends an expedited pre-issue process, express confirmation of the effective date and a clear distinction between registration and a binding ruling. Investors and employees who acquire shares in reliance on the company's IBCC status should have certainty at the time of acquisition, not only after the fact.

Resourcing and timeliness

56. The effectiveness of the registration framework will depend upon the Industry Secretary being adequately resourced to process applications in a timely manner. Start-up companies often operate on compressed timeframes and require certainty of IBCC status before issuing equity to investors or employees. Capital raising rounds may close within weeks. Employee share grants may be made as part of recruitment processes with defined timelines. Delays in the registration process could undermine the policy objectives of the concession by creating uncertainty at the point of investment or employment decision.

57. Subsection 115-165(4) already provides that, if the Industry Secretary does not register a company within 60 days of receiving the application, pausing while further information requested under subsection 115-165(3) is awaited, the Industry Secretary is taken to have refused registration. The Committee recommends that the default outcome instead be deemed registration, subject to integrity safeguards and a power to revoke, and that the 60-day period be shortened for straightforward applications. A timeframe of 30 business days for straightforward applications would be appropriate, with a longer period available for complex cases.

11. Company-level administrative failures should not retrospectively prejudice investors

Automatic suspension for failure to lodge annual reports

58. Proposed section 115-167 does not itself determine whether an interest remains an IBCC asset. Suspension operates through the disqualified asset rules: under paragraph 115-160(1)(b), an interest is a disqualified asset while the company's registration has ceased to have effect, and under paragraph 115-145(1)(f) the disqualified asset test is applied at the time of the CGT event. The Committee is concerned that this mechanism may produce consequences that are disproportionate to the administrative failure and inconsistent with principles of natural justice. Employees, minority shareholders, angel investors without board control, and former employees who no longer have any relationship with the company should not lose the benefit of an interest because of a change of management, administrative oversight, or the company's focus on a critical product launch.

59. Subsection 115-167(2) already provides that, if the suspension ends, the company is taken to have been registered during the suspension period. Lodging the outstanding report therefore restores the position. The residual risk is that a CGT event may happen during a period of suspension. The Committee recommends that an asset not be treated as a disqualified asset by reason only of a suspension that is subsequently lifted.

Retrospective cancellation consequences

60. Proposed section 115-168 provides for cancellation of IBCC registration. Automatic cancellation occurs under subsection 115-168(1) where an annual report is not given before the end of the income year in which it is due, subject to the discretion in subsection 115-168(2) to accept a late report where the delay was due to exceptional circumstances beyond the company's control. The Industry Secretary may cancel registration under subsection 115-168(3) where the company never met a requirement in section 115-155, where registration or an annual report involved fraud or serious misrepresentation, or where registration or an annual report was based on untrue, incorrect or incomplete information. The Committee is concerned about the potential for cancellation to affect employees, minority shareholders, angel investors, and former employees who acquired IBCC assets in reliance on the company's status.

61. Under subsection 115-169(2), cancellation on the grounds in subparagraphs 115-168(3)(a)(i) and (ii) and subparagraph 115-168(3)(b)(i) results in the company being taken never to have been registered. Section 115-177 disapplies the amendment periods in section 170 of the Income Tax Assessment Act 1936, so investors face amended assessments without the usual time limits. The combined effect of retrospective cancellation and unlimited amendment power is inconsistent with the principles of natural justice and proportionality: innocent investors, employees, and minority shareholders should not bear consequences for conduct of which they had no knowledge and over which they had no control. The Committee recommends that the retrospective effect of subsection 115-169(2) be confined to holders who were knowingly party to the relevant conduct and that the unlimited amendment power in section 115-177 be subject to a defined outer limit for innocent holders. The Committee retains its recommendation for a right of review under proposed Subdivision 115-BC. The reviewable decisions are listed in section 115-171; internal review is sought under section 115-173 within 28 days, and external review lies to the Administrative Review Tribunal under section 115-176. However, only the company may apply for internal review, so affected investors and employees have no standing. The absence of standing for the persons most directly affected by cancellation is a significant gap in the review framework.

12. The employee start-up concession and the innovation concession should be independent, alternative pathways

62. The Committee reiterates the concerns raised in its earlier submission regarding the interaction between the IBCC, the broader capital gains tax reforms, and Division 83A of the ITAA 1997. This interaction is one of the most significant issues raised by the exposure draft legislation. The start-up employee share scheme concession in section 83A-33 of the ITAA 1997 is one of the most important tax settings supporting Australia's innovation economy. Its economic value depends upon the combination of three elements: exclusion of the upfront discount from assessable income, capital account treatment, and access to the 50 per cent capital gains tax discount on disposal.

63. For employees, the employee share scheme start-up concession in section 83A-33 should remain a standalone route to discounted capital gains tax treatment without

requiring the separate innovation conditions to be satisfied. If Government does not preserve that standalone outcome, the combined rules must contain an express no-worse-off principle so that overlapping requirements are coordinated rather than cumulative and the employee receives the benefit of the more favourable and less onerous standard.

64. The primary recommendation is that qualification under the employee share scheme start-up provisions should continue to carry discounted capital gains tax treatment without requiring the employee, the interest, or the company also to satisfy the separate innovation conditions. The employee share scheme start-up regime has its own policy rationale and eligibility architecture. If an employee satisfies that regime, the discounted capital gains tax outcome should not depend upon a second determination that the company satisfies the innovative company test, the predominant activity test, registration requirements or other conditions of the IBCC regime.

65. The policy rationale is especially strong because employees often accept equity in substitution for cash remuneration which the business cannot afford to pay. They accept employment risk, business failure risk, illiquidity, and equity risk and contribute directly to the creation of business value. A start-up can be an appropriate business for employee equity participation even if it cannot establish every element of the proposed innovation regime. The preferred outcome is therefore that the employee pathway and the innovation pathway operate independently.

66. If Government nevertheless links the employee outcome to the innovation regime, the conditions must be coordinated rather than cumulative. Where both regimes regulate the same policy issue, satisfaction of the less onerous applicable requirement should be sufficient. A condition already tested under the employee share scheme start-up regime should not be retested under a stricter innovation threshold merely because discounted capital gains tax treatment is sought. Conversely, where the innovation regime provides a more favourable rule, the employee should be entitled to rely on that rule.

67. The no-worse-off principle should apply to company age and size criteria, issue timing, registration, innovation and predominant activity tests, employee share trust mechanics, the three-year holding period, compulsory disposal on cessation of employment, and subsequent company-level reporting or compliance. In particular, an employee should not lose discounted treatment because an employer later fails a company-level administrative requirement which forms no part of the employee share scheme start-up policy and which the employee cannot control.

68. The legislative hierarchy should be explicit: first, a qualifying employee share scheme start-up interest retains discounted capital gains tax treatment without needing to satisfy the innovation conditions; secondly, if interaction with the innovation regime is required, the requirements operate as alternatives or coordinated tests rather than cumulative gateways; and thirdly, wherever both regimes impose a condition dealing with the same subject matter, the more favourable and less onerous standard applies to the employee.

Options and notes treated as acquired at option or note acquisition time

69. The Committee welcomes the provision in proposed subsection 115-150(5) that, where a share is acquired by exercising an option, or converting a note, which was an IBCC asset, the share is taken to be acquired at the time the option or note was acquired for the purposes of subsection 115-150(1). The Explanatory Memorandum at paragraph 1.32 describes the rule as addressing the minimum holding period. The operative text deems acquisition time but does not expressly deem the resulting share to have been issued when the option or note was issued, or to have been issued while the company was an IBCC company. It should expressly address paragraphs 115-150(1)(c), (d), (e) and (f). Interests issued before 1 July 2027 are dealt with under section 115-145 of the Income Tax (Transitional Provisions) Act 1997. Because the transitional provision applies only paragraphs 115-150(1)(a), (b), (e) and (f) of the ITAA 1997, it is also unclear whether the resulting share can inherit the status of an option or note issued before 1 July 2027. The Committee recommends an express continuity rule for both ongoing and transitional interests.

The multi-event architecture issue remains

70. The Committee notes that the multi-event architecture of Division 83A and Subdivision 130-D of the ITAA 1997 continues to create difficulties for the IBCC. Depending on the type of interest, the following may occur at different times: grant of a right or option; vesting; exercise; acquisition of shares; cessation of employment; lifting of disposal restrictions; the deferred taxing point; determination of the ESS assessable amount; determination of cost base; application of CGT acquisition date rules; and disposal of the share.

71. The proposed CGT transition rules appear to assume that a taxpayer holds a CGT asset at 1 July 2027 being an eligible share, that the cost base of that eligible share is known, and that a deemed disposal and reacquisition can be calculated at that time. Sections 112-155 and 112-165 of the ITAA 1997 provide for a deemed disposal at the end of 30 June 2027 and reacquisition at the start of 1 July 2027. For many employee share scheme interests, this assumption is incorrect. For tax-deferred shares, the cost base may depend on the ESS deferred taxing point. If the deferred taxing point has not occurred by 1 July 2027, the taxpayer may not yet know the amount to be included in assessable income, and the grandfathered gain may be impossible to calculate. The Law Council's submission of 9 June 2026 raised the unresolved interaction between Subdivision 112-E and Division 134 of the ITAA 1997 for options acquired before 1 July 2027.

72. Options and rights create further difficulty because the asset originally acquired may not be the asset ultimately disposed of. An employee may hold an option at 1 July 2027 but later exercise it and dispose of the resulting share. Unless continuity rules are enacted, pre-1 July 2027 economic growth may fail to be preserved.

73. The Committee recommends that the transitional provisions be reframed to accommodate the existing employee share scheme architecture, including by providing specific rules for interests where the cost base is not yet determined at the transition date and by ensuring that pre-commencement economic appreciation is

preserved where an employee share scheme interest was acquired before 1 July 2027, even if the legal form of the relevant asset later changes.

Out-of-the-money options illustrate the problem

74. Out-of-the-money options may have little or no value when granted. They may later become valuable because of business growth. If such options are held before 1 July 2027 but exercised after that date, the economic appreciation may have accrued substantially before commencement of the new regime.

75. However, if the grandfathering mechanism attaches only to the option and not to the resulting share, the pre-commencement growth may be taxed entirely under the new regime. That is not an appropriate transitional outcome. A coherent rule should preserve pre-1 July 2027 economic appreciation where an employee share scheme interest was acquired before that date, even if the legal form of the relevant asset later changes.

Existing ESS interests should be grandfathered or deemed to qualify

76. The Committee recommends that employee share scheme interests issued before commencement should either: remain subject to current CGT treatment; be carved out from the new regime; or be deemed to satisfy the IBCC innovation requirements. At minimum, existing start-up concession options and shares should be protected.

77. Employees who accepted equity under the existing rules should not be retrospectively exposed to new eligibility requirements. The existing start-up ESS concession framework represented a settled expectation that employee equity in qualifying start-ups would receive concessional CGT treatment. The IBCC should preserve that expectation, not displace it with a more complex and uncertain framework.

Employee equity is not passive investment

78. Employees of innovative start-ups are not passive investors seeking concessional treatment for investment returns. They accept below-market remuneration, employment risk, business failure risk, illiquidity, uncertainty as to exit timing, dilution risk, and limited ability to sell or diversify. The tax system has historically recognised this bargain through employee share scheme concessions and CGT treatment. The broader CGT reforms should not inadvertently undermine that settled policy.

79. The proposed changes risk materially reducing the value of existing employee share arrangements by reducing the start-up concession from a meaningful employee ownership incentive to a mere timing deferral mechanism. This would undermine the policy objective of supporting innovation and weaken one of Australia's most effective mechanisms for attracting and retaining talent in early-stage businesses. Employee taxpayers may also be neither best placed nor able to assess eligibility for the concession, which compounds that risk.

Testing time for ESS interests

80. The Committee considers that the IBCC should clearly specify when eligibility is tested for options, rights and similar instruments issued under employee share schemes. The Committee recommends that eligibility should generally be tested at grant for employee options and rights. A company may satisfy the proposed age, turnover and innovation tests at grant but fail them at exercise because it has successfully scaled. Testing at grant is the time when the employee makes the relevant economic decision and accepts the risk.

81. It would be anomalous and antithetical to the policy objectives of the IBCC for employees to lose concessionary treatment because the company succeeded. The Committee recommends that the legislation expressly provide that the IBCC company requirements are tested at the time of grant of the option or right, not at the time of exercise or disposal.

13. The three-year holding requirement should distinguish voluntary from compulsory disposals

82. The Committee welcomes the reduction of the minimum holding period from the five years proposed in the Consultation Paper to three years in proposed paragraph 115-150(1)(f) of the ITAA 1997. The three-year period resembles the minimum holding period used in subsection 83A-45(5) for the start-up employee share scheme concession, but the tests differ: subsection 83A-45(4) concerns how the scheme must be operated, and the ESS minimum period can end on cessation of employment. Proposed paragraph 115-150(1)(f) instead tests the period for which the asset is held and has no general cessation-of-employment exception. The change also reflects the recommendations of the Law Council and other stakeholders.

83. The Committee also welcomes the exception from the three-year holding period where a CGT event occurs in relation to the asset as part of a takeover or scheme of arrangement in which substantially all of the interests in the IBCC company are acquired. However, subparagraph 115-150(1)(f)(ii) is in fact expressed by reference to interests acquired under **a particular scheme** rather than a takeover or scheme of arrangement. **Scheme** is not confined for this purpose. The Committee recommends that the provision be drafted to identify the intended transactions with precision so that its scope is not left to the general definition of scheme. This exception recognises the commercial reality that founders, employees, and investors may have limited control over the timing of exit events.

84. A minimum holding period can serve a legitimate integrity purpose by distinguishing committed risk investment from voluntary short-term realisation. That rationale does not justify applying the rule in the same way where the investor has no practical choice about disposal. The relevant question is why the investor ceased to hold the interest, not merely whether the interest was held for three years. The legislation should distinguish voluntary early realisation from compulsory or involuntary disposal and provide a broader exception for circumstances outside the investor's practical control.

14. Compulsory disposal on cessation of employment

85. Employee share scheme rules frequently require or trigger a sale, transfer, surrender, buy-back or other dealing with an employee's interests when employment ceases. Proposed paragraph 115-150(1)(f) contains no general exception where an employee is compelled to deal with an interest under the plan before three years have elapsed. The present rule can create arbitrary differences between employees in economically equivalent positions: an employee whose plan permits retention may satisfy the holding period, while an employee whose plan requires transfer or buy-back on cessation may fail.

86. The legislation should expressly provide that the minimum holding period does not cause an interest to fail where the employee is required to dispose of, transfer, surrender, sell back or otherwise deal with the interest under the employee share scheme or associated arrangements as a consequence of cessation of employment. More fundamentally, where the interest qualifies under the employee share scheme start-up concession, the discounted treatment should continue without importing the separate innovation holding-period conditions. If the regimes are linked, the no-worse-off principle should preserve the cessation-of-employment treatment in subsection 83A-45(5) and avoid imposing a more onerous IBCC holding condition on the employee.

15. The direct-issue restriction is drawn too broadly

87. The Committee welcomes the inclusion of employee share trust interests in proposed subparagraph 115-150(1)(e)(iv) of the ITAA 1997. This recognises that many innovative companies use employee share trusts as a mechanism for providing equity-based remuneration to employees. The inclusion of these interests within the scope of IBCC assets is an important step towards accommodating the practical structures used by innovative businesses.

88. However, proposed paragraph 115-150(1)(e) continues to require that the relevant interest be issued directly by the company, subject only to specified exceptions. The restriction is drawn too broadly. Legitimate early-stage transactions can involve existing shares: founders may transfer equity to bring additional participants into the business, employee ownership arrangements may use existing shares, and restructures and succession arrangements may involve transfers rather than new issues. The relevant policy question should be whether the investor holds a genuine at-risk interest in a qualifying innovative start-up, not whether the interest was issued directly.

89. The Committee recommends that the direct-issue rule be broadened or supplemented by additional exceptions for genuine transfers that do not raise the integrity concern addressed by the rule. The exceptions should include transfers approved or facilitated by the IBCC company, transactions within an employee share trust, founder transfers connected with bringing participants into the business, and restructures or succession arrangements in which the holder continues to bear genuine economic risk.

90. For employee interests, the preferred stand-alone position means that the innovation direct-issue restriction should not displace the treatment available under the employee share scheme start-up concession. Under the fallback no-worse-off position, the employee should be entitled to rely on whichever acquisition rule is more favourable and should not be required to satisfy both sets of acquisition conditions cumulatively.

16. Economic continuity should be applied consistently

91. The Committee notes that proposed subsection 115-150(6) provides continuity rules for replacement assets received under certain CGT rollovers but excludes Division 122 (transfer of assets to a company) and Subdivision 124-M (scrip-for-scrip rollovers).

92. The exclusion of Division 122 is of concern because it is commonly used by founders and early-stage shareholders to transfer assets to corporate structures in preparation for capital raisings, expansion, or commercial restructuring. Founders who initially hold shares directly may need to transfer them to a holding company structure to facilitate investment, establish international operations, or implement asset protection arrangements. These are commercially legitimate transactions that should not result in the loss of IBCC status.

93. The exclusion of Subdivision 124-M is of particular concern because scrip-for-scrip rollovers are the standard mechanism by which shareholders exchange their shares in a target company for shares in an acquiring company in the context of a takeover or scheme of arrangement. While the exposure draft includes an exception from the holding period for takeovers and schemes, the absence of a continuity rule for scrip-for-scrip rollovers means that the replacement shares may not be treated as IBCC assets, even though the holder's economic interest is substantially maintained. Paragraph 1.39 of the Explanatory Memorandum states that the exclusion reflects the risk of significant changes in the underlying economic interests and that the replacement asset may qualify independently. That integrity concern is accepted, but independent qualification will rarely assist because the acquiring company will usually not be an IBCC company.

94. Paragraph 1.39 of the Explanatory Memorandum states that the scrip-for-scrip rollover and the Division 122 rollovers for wholly owned companies are excluded because they can apply where there are significant changes in the underlying economic interests represented by the replacement asset, and that the replacement asset may still be an IBCC asset if it independently meets the requirements in its own right. The Committee accepts that integrity concern but recommends that the exclusions be replaced with a targeted test directed at whether the holder's economic interest is substantially maintained, rather than an outright exclusion. Independent qualification will rarely assist because the acquiring company will usually not be an IBCC company. The Committee also recommends that Treasury confirm the treatment of Division 615 restructures, on the basis that Division 615 appears to be a replacement-asset rollover and therefore already within subsection 115-150(6), and that the position should be stated expressly.

17. The transitional regime

95. The Committee welcomes the transitional rules for assets issued before 1 July 2027 in proposed section 115-145 of the Income Tax (Transitional Provisions) Act 1997. These rules recognise that investors and employees who acquired interests before the commencement date should not be retrospectively excluded from the concession.

The innovation test for the 2025–26 income year

96. The transitional rules require that, for the later of the 2025–26 income year and the income year in which the company was incorporated, the company satisfy both the innovative company test in subsection 115-155(2) and the predominant activity test in subsection 115-155(5), under paragraphs 115-145(5)(d) and (e) of the Income Tax (Transitional Provisions) Act 1997. The Committee is concerned that this requirement imposes a retrospective testing obligation on existing ventures. Many founders, employees and investors made commercial decisions years before the IBCC was contemplated or existed. They could not reasonably have anticipated that future tax outcomes would depend upon demonstrating satisfaction of innovation criteria that had not yet been proposed. The other transitional conditions are that the company be registered before the CGT event happens under subsection 115-145(2), that at the time of registration it be unlisted unless it was listed before 11 September 2026, be an Australian resident and meet the Australian staff and asset tests under subsection 115-145(3), and that on 30 June 2027 it and any affiliate have been incorporated for less than 15 years under subsection 115-145(4).

97. The Committee recommends that the transitional rules include a simplified pathway for existing ventures, and that the requirement to satisfy the innovation test be relaxed for companies that can demonstrate a genuine history of innovation activities. At minimum, the transitional rules should allow a company to satisfy the innovation test by reference to any income year in the three years preceding commencement, rather than requiring testing in a single specified year.

Deemed qualification for existing ESIC companies and start-up ESS interests

98. The Committee recommends that companies that self-assessed as early-stage innovation companies for the purposes of the ESIC tax incentive in Subdivision 360-A of the ITAA 1997, or obtained a private ruling to that effect, be deemed to satisfy paragraphs 115-155(2)(a) to (e) for the transitional year. Early-stage innovation company status is self-assessed, with a private ruling from the Commissioner available where certainty is required; there is no general assessment by Innovation and Science Australia. Paragraph 1.63 of the Explanatory Memorandum states that the innovative company test is similar to subparagraphs 360-40(1)(e)(i) to (v) of the ITAA 1997, but the two sets of requirements are distinct. Paragraph 1.67 states that meeting a safe harbour condition does not make a company an early-stage innovation company. The recommendation therefore relies on the substantive similarity of the tests and the availability of contemporaneous ESIC documentation, rather than on a prior assessment by a government body. The deeming rule should identify the issue or other relevant time at which ESIC status was established and

specify what contemporary evidence suffices. Companies with documented qualifying ESIC status should not be required to undergo a further, potentially different assessment under the IBCC framework.

99. Similarly, the Committee recommends that employee share scheme interests issued under the start-up concession in section 83A-33 of the ITAA 1997 before 1 July 2027 be deemed to be IBCC assets. The companies that issued these interests satisfied the eligibility criteria for the start-up concession at the time of issue. Employees who accepted equity under the existing rules should not be retrospectively exposed to new eligibility requirements.

100. This recommendation is consistent with the broader principle that transitional rules should protect existing expectations and should not impose retrospective burdens on taxpayers who made decisions under the existing law.

Turnover test at time of share issue

101. The transitional rules require the company to have had aggregated turnover not exceeding $50 million for the later of the 2025–26 income year and the income year of incorporation, under paragraph 115-145(5)(c) of the Income Tax (Transitional Provisions) Act 1997. Paragraph 1.170 of the Explanatory Memorandum states that fixing the turnover test to those years is intended to avoid disincentivising growth. The Committee's concern is therefore narrower than it may appear but remains relevant for companies incorporated well before 2025–26 whose turnover peaked in that year. The Committee recommends that the turnover test allow testing at the time the equity was issued or acquired, rather than requiring testing at a fixed income year. A company that satisfied the turnover threshold at the time of share issue but has since grown beyond the threshold should not be disqualified on a retrospective basis.

102. The Committee also recommends that the turnover test for transitional purposes be consistent with any future increase to the turnover threshold for the ongoing IBCC framework.

18. Venture capital and carried interest

103. The Committee welcomes the carried interest provisions in the exposure draft legislation. The IBCC discount is available for a capital gain from CGT event K9 to a general partner in a VCLP, an ESVCLP or an AFOF, or a limited partner in a VCMP, but only to the extent the gain is reasonably attributable to an IBCC asset that is not a disqualified asset at the time of the event. The asset must have been issued directly by the IBCC company to, and held for at least three years by, the VCLP, ESVCLP, AFOF or VCMP under subparagraphs 115-150(1)(e)(iii) and 115-150(1)(f)(v). The partner must not be a company, a complying superannuation entity or a foreign resident and must not have chosen cost base indexation for the relevant part of the gain. These provisions recognise that carried interest may relate to early-stage investment in qualifying start-ups.

Tracing through fund structures

104. However, the practical operation of the concession through fund structures remains unclear. Funds may hold mixed portfolios, including IBCC-qualifying investments, non-qualifying venture investments, follow-on investments, secondary acquisitions, offshore investments, trust interests, and convertible instruments. The legislation must explain how eligibility is traced through the fund structure to the ultimate carried interest recipient.

105. The Committee recommends that the legislation include specific tracing rules for fund structures and that guidance be provided on how the IBCC discount is calculated where a fund holds a mixed portfolio of qualifying and non-qualifying investments. The tracing rules should accommodate the practical realities of fund management, including reinvestment, follow-on funding, portfolio company restructures, and co-investment arrangements.

Waterfall distributions and mixed portfolios

106. Many Australian venture capital and private equity funds operate on a whole-of-fund or European waterfall. Carried interest may not be distributed until investors have received return of capital and preferred returns across the entire fund. If early IBCC-qualifying investments are sold before carry is payable, later carry distributions may be economically attributable to the success of the whole fund, not easily traceable to a particular investment.

107. A strict investment-by-investment tracing rule may therefore produce arbitrary outcomes depending on the timing of exits and the structure of waterfall provisions. The Committee recommends that Treasury consult specifically with venture capital and private capital fund advisers on this issue and provide guidance or legislative rules that accommodate standard fund waterfall arrangements. The Committee also recommends that the tracing rules address the position of co-investment vehicles, parallel funds and associated entities that are common in institutional venture capital.

19. Removal of the $10 million lifetime cap

108. The Committee welcomes the removal of the $10 million lifetime cap that the Consultation Paper proposed. The exposure draft legislation does not impose a lifetime cap on the total capital gain eligible for the IBCC discount. As the Law Council explained in its earlier submission, innovation ecosystems depend on a small number of exceptional successes, and a cap of $10 million risked being reached quickly by founders or early employees in genuine high-growth companies. The removal of the cap addresses those concerns and is consistent with the policy objective of encouraging genuine long-term investment in innovative Australian businesses.

109. The Committee recommends that no lifetime cap be introduced in the final legislation. The asymmetric return profile of venture capital investment means that the majority of economic value and ecosystem returns are generated by a relatively small number of highly successful investments. Imposing a cap on the concession would risk limiting support precisely at the point of exceptional success, discouraging serial

entrepreneurship and repeat investment, and encouraging globally mobile founders and investors to locate their activities outside Australia.

20. The rulings framework

110. The Committee welcomes the Industry Secretary's ruling powers in Division 363 of Schedule 1 to the Taxation Administration Act 1953, which provide a mechanism for companies to obtain rulings on their IBCC company status that bind the Industry Secretary and the Commissioner where the ruling applies to the relevant entity and that entity relies on it (section 363-65). The availability of binding rulings is an important integrity and certainty mechanism for investors and employees.

Dual administration

111. The Committee notes that the exposure draft legislation creates a dual administration framework, with the Industry Secretary responsible for registration and rulings on IBCC company status and the Commissioner of Taxation responsible for the assessment of the IBCC discount and the determination of a taxpayer's overall tax liability. Paragraph 1.136 of the Explanatory Memorandum states that, in assessing taxpayers, the Commissioner is bound, subject to the application and reliance requirements in section 363-65, by Industry Secretary rulings about whether a company is an IBCC company and whether assets are disqualified assets, and may apply for such a ruling. The concern is therefore directed at the residual matters on which the Commissioner may still form a different view, rather than at the matters determined by an applicable ruling.

112. Subsection 363-70(2) of Schedule 1 to the Taxation Administration Act 1953 removes paragraph 115-145(1)(e) and subsection 115-155(1) from the matters on which the Commissioner may rule. The Commissioner may therefore still form a different view about whether an asset is an IBCC asset under section 115-150 and whether the taxpayer is an eligible entity. The Commissioner is bound in relation to an entity only where an applicable ruling has been made and that entity has relied on it (section 363-65). The interaction between the Industry Secretary's determination and the Commissioner's assessment should be clearly specified in the legislation.

113. The Committee recommends that the legislation clarify the interaction between the Industry Secretary's registration and ruling functions and the Commissioner's assessment functions. Section 115-179 requires each regulator to comply with the other's information requests. The legislation should specify how the Commissioner may address the residual questions of whether an asset is an IBCC asset under section 115-150 and whether the taxpayer is an eligible entity and should recognise that the Commissioner is bound by an Industry Department ruling only where the ruling applies to the relevant entity and that entity has relied on it.

114. The Committee notes a cross-reference error in the exposure draft. Subsections 363-5(2) and 363-25(2), and paragraph 363-70(2)(a), in Schedule 1 to the Taxation Administration Act 1953 identify the disqualified asset requirement as paragraph 115-145(1)(e) of the ITAA 1997, whereas the disqualified asset condition appears in paragraph 115-145(1)(f), with paragraph 115-145(1)(e) dealing with carried interests. The Committee recommends that these three cross-references be

corrected before introduction and that the consequential explanation of the Industry Secretary's and Commissioner's respective ruling powers be checked.

Adequate resourcing and expedited timeframes

115. The Committee recommends that the Industry Secretary be adequately resourced to process registration applications and ruling requests in a timely manner. Start-up companies and their investors require certainty of IBCC status before issuing equity or making investment decisions. Subsection 115-165(4) already provides a 60-day deemed refusal outcome for registration applications, subject to the pause while requested information is awaited. Section 363-50 in Schedule 1 to the Taxation Administration Act 1953 also provides that, if a ruling has not been made within 60 days, the applicant may give notice requiring a decision within a further 30 days, failing which the ruling is taken to have been refused. The Committee recommends shortening these periods and reconsidering deemed refusal. If deemed approval or a favourable ruling is adopted, the legislation would need to specify its effect on the substantive company, asset and holder tests and provide safeguards against approval based on incomplete information.

116. The Committee also recommends that the review framework in proposed Subdivision 115-BC be adequately resourced and that the timeframes for internal review and applications to the Administrative Review Tribunal be clearly specified. The right of review is an important safeguard, but it will be of limited practical value if delays in the review process mean that investment and commercial decisions must be made before the review is determined.

21. Recommended legislative design

117. The Committee considers that the exposure draft requires further refinement before the legislation is introduced to Parliament. The central concern is that the draft has not yet translated the policy objective into a sufficiently simple, certain, and effective investment incentive. It combines multiple substantive, temporal and administrative gateways, leaves formative-stage interests exposed, and risks making the availability of relief depend on company-level compliance matters outside the control of investors and employees. The innovation testing framework, excluded activities, direct-issue restriction, holding-period rules, transitional arrangements, rollover continuity rules, and registration framework should be revised consistently with the objective of supporting genuine at-risk investment through the innovation funding lifecycle.

118. First, the legislation should identify an eligible Australian start-up by reference to a limited number of clear and objectively ascertainable requirements concerning matters such as age, size, listing status, and appropriate Australian connection.

119. Secondly, the legislation should identify genuine innovation through a principles-based test concerned with whether the business is established and operated to develop and generate commercial success from genuine innovation. Growth potential, scalability, market reach and competitive advantage should operate as factors or safe harbours rather than cumulative gateways.

120. Thirdly, the legislation should protect genuine at-risk investment. Once the company falls within the intended policy class, genuine investment by founders, early investors and employees should not be defeated by arbitrary issue timing, registration as a precondition, subsequent company administration, the use of a legitimate transfer rather than a new issue, a compulsory disposal or employee plan mechanics.

121. Fourthly, the legislation should preserve independent employee relief. The preferred position is that qualification under the employee share scheme start-up concession should itself preserve the discounted capital gains tax treatment without requiring satisfaction of the separate innovation conditions. If the legislation nevertheless connects the employee outcome to the innovation regime, the two sets of requirements must not be cumulative: overlapping conditions should be coordinated and the more favourable and less onerous standard should govern.

122. Fifthly, registration should operate as a safe harbour. It should provide optional certainty rather than constitute a mandatory gateway, and objective satisfaction of the substantive conditions should remain available without registration.

123. Sixthly, the legislation should target integrity measures directly. It should exclude activities because of substantive policy, distinguish voluntary short-term realisation from compulsory disposal, address genuine secondary-market integrity concerns without excluding every transfer, and avoid visiting company-level administrative failures on investors who cannot control them.

Conclusion

124. The Committee supports the policy objective of encouraging innovation, entrepreneurship, employee ownership, and long-term productive investment. The exposure draft legislation represents a constructive step towards achieving that objective, and the Committee acknowledges the improvements made in response to stakeholder submissions on the Consultation Paper.

125. The Committee recommends that Treasury undertake further targeted consultation and revise the proposed design before the legislation is introduced. The Committee considers that the issues identified in this submission are capable of resolution through further refinement of the exposure draft and would welcome the opportunity to participate in that process.

126. The central recommendation is that the IBCC be redesigned as an investment incentive rather than an administrative eligibility regime. It should identify genuine innovative Australian start-ups through clear substantive criteria and provide predictable treatment for genuine at-risk investment by founders, early investors, and employees. Registration, safe harbours, and integrity provisions should support those outcomes rather than become additional barriers.

127. For employees, the legislation should expressly preserve the employee share scheme start-up concession as a standalone route to discounted capital gains tax treatment. If the discounted outcome is nevertheless made dependent upon interaction with the innovation regime, an explicit no-worse-off principle must apply: overlapping conditions must not be cumulative, and the more favourable and less onerous standard must govern. A successful regime should provide certainty at the

time equity is issued, preserve existing employee and founder expectations, support both financial capital and human capital, and ensure that Australia remains an attractive jurisdiction in which to create, fund, scale and retain innovative businesses.

128. The Committee would welcome the opportunity to participate in further consultation and to provide assistance to Treasury in refining the exposure draft legislation. The Committee considers that the matters raised in this submission are capable of resolution through targeted amendments to the exposure draft and further consultation with affected stakeholders.

129. The Committee also recommends that the legislation include a review mechanism requiring a statutory review of the operation of the IBCC within three years of commencement. Such a review would enable the Government to assess whether the concession is achieving its policy objectives, whether the monetary thresholds remain appropriate, and whether the innovation testing framework is operating effectively. The review should include consultation with industry participants, the venture capital sector, employee equity stakeholders, and the tax profession.

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