CPA Australia Ltd
ABN 64 008 392 452

Level 20, 28 Freshwater Place
Southbank VIC 3006 Australia

GPO Box 2820 Melbourne
VIC 3001 Australia

P 1300 737 373
Outside Aust +613 9606 9677

cpaaustralia.com.au

Ms Diane Brown
Deputy Secretary, Revenue Group
The Treasury
Langton Crescent
PARKES ACT 2600

Email: TaxChanges@treasury.gov.au

10 July 2026

Dear Diane,

Capital gains tax reforms – arrangements for innovative start-ups

CPA Australia is Australia's leading professional accounting body and one of the largest in the world. We represent the diverse interests of more than 176,000 members in over 100 countries and regions. We make this submission in response to Treasury's consultation paper: **Capital gains tax reforms – arrangements for innovative start-ups** on behalf of our members and in the broader public interest.

Our members work in all sectors of the economy, including as advisers to start-ups, early-stage investors and small businesses. This submission draws on feedback from members of CPA Australia's Tax Centre of Excellence with direct practitioner experience applying the Early Stage Innovation Company (ESIC) regime and advising innovative businesses, and on findings from CPA Australia's 17th annual Asia-Pacific Small Business Survey (2025–26), which surveyed more than 4,100 small businesses across 11 markets, including more than 500 in Australia.

Executive summary

CPA Australia supports the introduction of a targeted CGT concession for early investment in innovative start-ups and welcomes consultation on this issue. Based on our own survey, Australian small businesses have ranked at or near the bottom of the Asia-Pacific region on innovation, growth and technology adoption for more than a decade, and our survey data consistently shows a strong correlation between innovation and business growth. Well-designed tax settings that reward genuinely innovative activity are a necessary part of any serious productivity agenda.

Our support for the concession in principle is accompanied by significant design concerns, which fall into four groups:

1. **Framing of the existing CGT treatment.** The paper presents the Innovative Business CGT Concession (IBCC) as maintaining existing CGT treatment for eligible shares. For holders who dispose between 12 months and five years, the IBCC is materially more restrictive than current law — those investors lose the existing 50 per cent discount and gain nothing in its place. (General comments; Question 5)

2. **Need for certainty.** Members' direct experience with ESIC including the holding-company problem confirmed in *ZWBX v FCT* [2024] AATA 2065 shows that a self-assessed, principles-based innovation test without a binding clearance pathway produces a regime that is narrow in practice regardless of its breadth on paper. (Question 4)

3. **Minimum five-year holding period – all or nothing.** The United States has just legislated away exactly this design in its Qualified Small Business Stock (QSBS) regime, replacing it with graduated 3/4/5-year relief. (Question 5)

4. **Technical issues**: treatment of options and convertible instruments (including Simple Agreement for Future Equity (SAFE) notes), the meaning of "independent", rollover and restructure interactions with the holding period and lifetime cap, the treatment of employee shares exchanged or converted on acquisition, and the interaction between the IBCC discount and the small business 50 per cent active asset reduction. (Questions 1, 4 and 7; Additional design issues.)

Key recommendations:

1. Introduce a binding pre-clearance or registration mechanism, preferably by extending the existing ATO private binding ruling pathway used for ESIC, available at or shortly after share issue, on which investors and employees can rely.

2. Enact a statutory safe harbour deeming ESIC-qualifying companies to satisfy the IBCC innovation principles at that time, and consider a bright-line alternative (analogous to the ESIC 100-point test) alongside the principles-based test.

3. Provide look-through treatment for genuine single-economic-enterprise group structures (HoldCo/IP Co/operating company arrangements), with appropriate integrity safeguards.

4. Allow the innovation and active-business requirements to be satisfied within 12 months of the share issue date, rather than strictly at issue, to accommodate companies with no operating history at first raise.

5. Replace the all-or-nothing five-year holding requirement with a graduated discount (for example, a partial discount from three years scaling to the full 50 per cent at five years), consistent with the recent US Qualified Small Business Stock (QSBS) reform.

6. Extend eligibility to options and convertible instruments that qualify for capital account treatment, with clear rules on when eligibility is tested and when the holding period commences.

7. Ensure continuity of IBCC eligibility, the accrued holding period and the lifetime cap where eligible shares including shares and options issued to employees under ESS/ESOP arrangements are exchanged or converted as part of an acquisition or restructure, so that a successful exit does not itself forfeit the concession.

8. Confirm that the IBCC discount operates in addition to, not as an alternative to, the small business 50 per cent active asset reduction, reflecting their distinct policy rationales.

9. Publish modelling on the eligible population at the $50 million turnover threshold relative to alternative (both higher and lower) thresholds, and publish ESIC take-up statistics as part of this process.

10. Release draft eligibility guidance including the innovation principles guidance and any Department of Industry, Science and Resources (DISR) or ATO clearance pathway well before the 1 July 2027 commencement date.

General comments

Three observations frame our response.

The IBCC deliberately reuses tested frameworks, the ESIC innovation principles, the existing 80 per cent active asset test, rather than inventing new concepts. This is the right call for administrability: practitioners and the ATO already have a body of guidance, rulings and case law on these tests.

The consultation paper states the IBCC "would maintain the existing CGT treatment for eligible shares." For a five-year-plus holder, that is accurate. But for a large class of early-stage holders, anyone disposing of eligible shares between 12 months and five years, the IBCC is materially *more* restrictive than the current law, under which the 50 per cent discount is available after a 12-month hold. From 1 July 2027 those investors receive neither the old discount (abolished) nor the IBCC discount (not yet available), and fall back to indexation plus the 30 per cent minimum tax which, as the paper itself acknowledges in justifying the IBCC, generally produces higher effective tax

rates for exactly this short-duration, low-cost-base profile. The five-year holding does not merely fail to address this gap for earlier exits; it is the gap. Our recommended response is a graduated holding structure (Question 5).

CPA Australia's Asia-Pacific Small Business Survey has, for 17 consecutive years, found Australian small businesses at or near the bottom of the region on innovation, growth and technology adoption. In our most recent survey, fewer than half of Australian small businesses reported growth in 2025, only 30 per cent said their 2025 technology investment improved profitability (among the lowest results in the region), and 15 per cent reported AI as their most significant technology investment against a regional average of 32 per cent. Our survey data consistently shows a strong correlation between innovation and business growth, and that Australia's ageing ownership profile, more than half of Australian small business owners are aged 50 or over, the second-oldest profile of any market surveyed, compounds the problem, because younger owners are more likely to innovate, adopt technology and pursue growth. A well-designed IBCC directly serves the cohort Australia most needs to encourage younger founders, their employees and their early backers. This is why getting the design details right particularly certainty of access matters so much. A concession that is generous on paper but inaccessible in practice will do nothing to shift these indicators.

Responses to consultation questions

Question 1 — Does the IBCC appropriately support investment in innovative start-ups?

Broadly yes, subject to the framing issue above and the design issues below. Two further observations:

Eligibility should extend to options and convertible instruments

The paper describes the concession as applying to "shares and options" of early investors in one place, but the eligibility criteria are framed exclusively around shares "issued as new equity". Employee share option plans are the dominant remuneration structure for start-ups globally: options allow employees to share in upside without funding an up-front acquisition, and they keep early-stage capital structures simple. Similarly, a significant share of Australian early-stage investment is now written through SAFE notes and convertible notes rather than direct equity subscriptions.

The rules should state clearly:

(a) that options and convertible interests qualifying for capital account treatment are eligible;

(b) when the eligibility tests (turnover, age, innovation) are applied for such instruments, at grant/issue of the instrument or at conversion/exercise; and

(c) when the five-year holding period commences.

If eligibility is tested and the clock started only at conversion, much of the concession's value for employees and early investors would be lost in practice.

"Independent" requirement needs definition

The paper requires the issuing company to be "unlisted and independent" but does not define independence. If independence is assessed by reference to shareholding concentration, it could inadvertently exclude founders and majority owners, the very participants the concession expressly aims to support. We assume independence is intended to exclude subsidiaries of broader corporate groups (consistent with the disqualifying characteristics table) and would ask Treasury to confirm this and define the term accordingly.

Question 2 — Do the 10-year age limit and $50 million turnover threshold appropriately target small innovative start-ups?

The age and turnover thresholds warrant closer examination, particularly as they apply to employee equity. The consultation paper accepts the policy rationale for employee equity: ESS and Employee Share Option Plan (ESOP)

arrangements help innovative companies attract and retain talent, and allow employees to share in the risk and upside of the business they are helping to build. The proposed thresholds, however, apply that rationale only to the earliest phase of a company's growth. Innovative Australian companies are staying private for longer, competing globally for talent for longer, and continuing to rely on employee equity well beyond the proposed limits. Employee equity is also a form of earned remuneration: employees who take a larger share of their remuneration as equity typically accept lower cash pay and illiquidity in exchange for a stake in the long-term growth they are helping to create. That is the kind of productive risk-taking the IBCC is designed to reward, and it does not cease when an innovative company begins to scale or crosses an arbitrary age or turnover threshold.

We therefore query whether company age and turnover are the best proxies for the policy objective the concession is seeking to achieve. The innovation principles and the $10 million lifetime cap already operate as targeted parameters within the proposed design, and are better calibrated to that objective than bright-line age and turnover limits. If thresholds are to be retained, Treasury should consider modestly higher settings for example, a $75 million turnover threshold and a 15-year age limit, and should, at a minimum, ensure that shares and options issued to employees while a company satisfied the eligibility criteria retain their concessional treatment as the company scales (see Question 7).

Question 3 — What criteria would be appropriate for a 15-year age limit for biotech, medtech and deep tech?

To remain administrable, eligibility should be anchored to existing objective markers already used elsewhere in the tax and innovation system, for example, Therapeutic Goods Administration (TGA) clinical trial phase milestones, or definitions already applied for Research and Development Tax Incentive (R&DTI) clinical-trials purposes, rather than a fresh sector-classification exercise. "Deep tech" has no settled legal definition; if it is to carry an extended eligibility period, it will need one, with clear guidance on boundary cases.

Question 4 — Are the innovation principles appropriate and workable?

This is where we have our most significant practical concerns, drawn from members' direct experience applying the near-identical ESIC innovation principles.

Holding company structures are problematic. Many groups protect intellectual property by holding it in an IP company separate from an operating company, both under a holding company, which is the entity investors actually subscribe into. The ESIC regime has no look-through for this structure, and it has already produced an adverse outcome: in *ZWBX v FCT* [2024] AATA 2065, the Tribunal found a holding company was not an ESIC because its activities were to finance and oversee the group rather than trade in its own right, even though the group's underlying activity was genuinely innovative. If the IBCC imports the same principles-based test without addressing this, the same outcome will recur for the very groups the concession is meant to support, and "top-hatting" and pre-IPO reorganisations create the same risk on a rolling basis.

Companies often cannot satisfy the tests at first raise. At the time initial shares are issued, a company may have no operating history against which the innovation or active-business requirements can be assessed. Members report situations in which the ATO has declined to rule where a company lacked sufficient history. We recommend the requirements be capable of being satisfied within 12 months of the share issue date, rather than strictly at issue.

Self-assessment risk. It is commercially risky for a company to hold itself out to investors and employees as "innovative" under a principles-based test without a binding determination, yet the tax risk of an incorrect assessment sits with investors and employees who have no visibility into the company's internal documentation. Multiple classes of stakeholder (employees under ESS/Employee Share Option Plan (ESOP) arrangements, external investors, fund general partners) will rely on the same company-level assessment, which makes certainty a threshold design requirement rather than an optional refinement.

ESIC is a narrow regime. ESIC's principles-based test is workable on paper but, in members' experience, difficult to apply with confidence in practice, and the population of qualifying investors is very small relative to the policy intent. We do not have ATO take-up statistics to quantify this; Treasury may hold these and we would welcome their publication as part of this process, but the qualitative pattern is consistent across member firms. This

experience is consistent with the broader pattern in CPA Australia's small business survey work: complexity and uncertainty are persistent barriers to Australian small businesses engaging with growth-supporting measures, and high-growth businesses are distinguished by their reliance on professional advice to navigate them. A concession whose availability cannot be confirmed at reasonable cost will simply not be priced into investment decisions.

Integrity cuts both ways. The ATO has already had to act against circular-financing schemes misusing the ESIC offset. A clearer registration or clearance pathway would reduce both legitimate-investor uncertainty and this integrity exposure.

Recommendations:

1. A binding pre-clearance or registration mechanism, available at or shortly after the relevant share issue, on which investors and employees can rely. We note companies can already seek private binding rulings from the ATO on ESIC qualification under the same innovation principles; extending or adapting that existing pathway for IBCC purposes would be faster and cheaper than building a new DISR process, though a legally binding DISR finding (as the paper contemplates) would also be workable.

2. A statutory safe harbour: a company that qualifies under the ESIC tests should be deemed to satisfy the IBCC innovation principles at that time, reducing duplication for companies navigating both regimes. Consideration should also be given to a bright-line alternative to the principles test, analogous to the ESIC 100-point innovation test, so that companies with objectively verifiable innovation markers are not forced through a subjective assessment.

3. Explicit look-through treatment for genuine single-economic-enterprise group structures (holding company/IP company/operating company arrangements), with appropriate integrity safeguards, rather than leaving the issue to be litigated company-by-company as in *ZWBX*.

4. Allow the innovation and active-business requirements to be met within 12 months of the share issue date.

Question 5 — Is the five-year minimum holding period appropriate?

We consider the all-or-nothing structure should be reconsidered, and the United States has just demonstrated why. Until mid-2025, the US QSBS regime adopted this approach: full exclusion only after five years, nothing before. Reform legislation effective for stock acquired after 4 July 2025 replaced it with a graduated scale specifically to remove that distortion: 50 per cent exclusion at three years, 75 per cent at four, and 100 per cent at five. The explicit rationale was to let founders, employees and investors respond to genuine earlier liquidity events. an acquisition, a secondary sale, without forfeiting the entire concession.

The IBCC's proposed minimum five-year holding period reintroduces precisely the lock-in distortion the US has legislated away, and it does so in a context where the downside of missing the threshold is harsher than under the pre-reform US rules: as set out in our general comments, an investor who exits at, say, four years receives no discount at all and faces indexation plus the 30 per cent minimum tax on what is typically a large nominal gain from a low cost base. This penalty falls hardest where investment capacity is most constrained and our survey evidence shows cost pressure leaving many Australian small business owners with little capacity to lock capital away for extended periods.

We recommend Treasury adopt a graduated discount for example, a partial discount available from three years, scaling to the full 50 per cent at five years rather than an all-or-nothing threshold. A graduated structure preserves the patient-capital signal while removing the cliff.

Question 6 — Does the $10 million lifetime cap appropriately balance support with targeting?

The overseas comparator regimes are generally smaller in absolute terms (UK Investors' Relief at £1 million; Canada's Lifetime Capital Gains Exemption (LCGE) at approximately A$1.4 million equivalent) — though those are exemption caps on the gain itself, whereas the IBCC cap operates on the gain before the 50 per cent discount applies, so the mechanics are not identical. The US, by contrast, has just increased its per-issuer cap (to US$15 million, or ten times basis) alongside moving to graduated full exclusion — a different and more generous

mechanic again. Given this spread, we do not think the international evidence points clearly to $10 million being either too high or too low; it is a defensible number, but Treasury should not lean heavily on "international practice" to justify it, since practice varies enormously in mechanic as well as quantum.

Two mechanical points require clarification:

- **Application to pre-commencement accruals.** It is unclear whether gains accrued to 30 June 2027 (which retain the existing 50 per cent discount under the transitional arrangements for the broader reforms) count towards the lifetime cap. We assume not, since the cap attaches to the IBCC concession rather than the outgoing discount, but this should be stated expressly.

- **Interaction with rollovers.** Where eligible shares are exchanged in a restructure (see Question 7), the rules should specify whether the cap is measured against the notional gain at the time of exchange or the ultimate gain on disposal of replacement shares.

Question 7 — Are the transitional arrangements appropriate and workable?

Broadly workable, but several practical issues need addressing:

Prior-period rollovers and restructures. Where a company has restructured before 30 June 2027 including the HoldCo/IP Co interpositions discussed under Question 4 it is unclear how the age and turnover tests apply to the resulting entity, particularly where Subdivision 124-M scrip-for-scrip or similar rollover relief was used. The same issues arise on an ongoing basis for post-commencement restructures: the rules should specify whether replacement shares received on rollover retain IBCC eligibility, whether the exchange is a notional CGT event generating a deferred discount gain, what cost base the replacement shares take, and how the exchange interacts with the five-year holding period and the lifetime cap. Without express continuity rules, ordinary commercial restructures, top-hatting ahead of a capital raise, pre-Initial Public Offering (pre-IPO) reorganisations, would silently destroy eligibility.

Employee shares exchanged or converted on acquisition. The continuity point is particularly acute for employees. Where employees receive shares or options in an eligible company under ESS or ESOP arrangements and that company is subsequently acquired, their interests are commonly exchanged or converted as part of the transaction. The rules should expressly provide that IBCC eligibility, the accrued holding period and access to the lifetime cap carry over to the replacement interests in those circumstances. An exit by acquisition is the most common liquidity event for the companies this concession targets; employees and start-ups should not be penalised for a successful acquisition outcome.

In addition, CPA Australia highlighted in its submission to the Senate Economics Legislation Committee on the CGT proposals that the government should not apply the 30 per cent minimum tax to gains on ESS interests where the nil cost base results from the specific operation of the start-up concession (see Issue 6, page 41 of CPA Australia's submission).

Convertible instruments on foot at commencement. Consistent with our Question 1 comments, the transitional rules should address SAFE notes and convertible notes issued before 1 July 2027 that convert to shares afterwards: whether the resulting shares are "new equity", when eligibility is tested, and when the holding period commences.

Assessment year mismatch. The transitional test asks whether a start-up meets the innovation principles "with respect to the 2025–26 income year" but the principles are inherently forward-looking (growth potential, scalability, addressable market). Companies and advisers will need clear guidance on how a backward-looking assessment of forward-looking criteria is meant to operate, particularly for ruling purposes.

Additional design issue — interaction with the small business CGT concessions

The consultation paper proposes that a significant investor (20 per cent or greater shareholding) must choose between the small business CGT concessions and the IBCC discount. We question the conceptual basis for treating these as alternatives. The 50 per cent discount the IBCC preserves is, on the consultation paper's rationale, compensation for the absence of a meaningful cost base to index — a proxy for indexation over a long holding period. The small business 50 per cent active asset reduction is a distinct incentive with a distinct policy

purpose: rewarding active small business ownership. Conflating them forces founders, the significant investors most likely to face this choice, to give up one legitimate concession to access another that addresses a different problem. We recommend the IBCC discount operate in addition to the active asset reduction where the relevant eligibility tests for each are independently satisfied, consistent with how the general discount and the active asset reduction stack under current law.

It should also not be assumed that a higher turnover threshold for the small business CGT concessions compensates for treating the two concessions as alternatives. The aggregated turnover test is only available to taxpayers who carry on a business. Many shareholders in innovative companies — including founders who have stepped back from day-to-day operations, early employees and other individual investors — do not themselves carry on a business, and so can only access the small business concessions through the maximum net asset value test, which remains unchanged at $6 million. For those taxpayers an increased income threshold provides no additional access at all. Their position is only protected if the IBCC discount and the small business concessions can each be accessed where their respective eligibility tests are independently satisfied.

Timing of guidance

Finally, and consistent with CPA Australia's submissions on the broader CGT reform package, we ask that the detailed eligibility guidance including the innovation principles guidance, the design of any DISR or ATO clearance pathway, and the treatment of options, convertibles and rollovers — be settled and published well before the 1 July 2027 commencement, rather than left to be resolved after enactment. Investment decisions in the 2026–27 year are already being made in the shadow of these rules; certainty delayed is, for this measure, concession denied.

Conclusion

CPA Australia supports the IBCC and commends the consultative approach taken in its design. Our recommendations are directed at a single objective: ensuring the concession is as broad in practice as it is on paper. The ESIC experience shows what happens when that gap is left open. We would welcome the opportunity to discuss any aspect of this submission, and to participate in further consultation on exposure draft legislation.

If you have any queries, please contact Jenny Wong, Tax Policy Lead on jenny.wong@cpaaustralia.com.au.

Yours sincerely,

Jenny Wong
Tax Policy Lead
Policy and Advocacy