



The Institute of Public Accountants

**Changing the Criteria of ‘Ineligible Activities’ in the Income Tax Assessment Act 1997**

3 June 2016

# IPA - Deakin SME Research Partnership

The Institute of Public Accountants (IPA) is one of the three legally recognised professional accounting bodies in Australia. The IPA has been in operation for over 90 years and has grown rapidly in recent years to represent more than 35,000 members and students in Australia and in more than 65 countries. The IPA has offices around Australia and in London, Beijing, Shanghai, Guangzhou, Hong Kong and Kuala Lumpur. It also has a range of partnerships with other global accounting bodies. The IPA is a full member of the International Federation of Accountants and has almost 4,000 individual accounting practices in its network, generating in excess of $2.1 billion in accounting services fees annually. The IPA’s unique proposition is that it is for *small business*; providing personal, practical and valued services to its members and their clients/employers. More than 75 per cent of IPA members work directly in or with small business every day. The IPA has a proud record of innovation and was recognised in 2012 by *BRW* as one of Australia’s top 20 most innovative companies.

In 2015 the IPA merged with the Institute of Financial Accountants of the UK to form the IPA Group, which is now the largest SME/SMP focused accounting body in the world.

In 2013, the IPA partnered with Deakin University to form the IPA Deakin University SME Research Partnership, a first in Australia. The goal of the partnership is to bring together practitioner insights with cutting edge SME academic research, to provide informed comment for substantive policy development.

The IPA Deakin SME Research Partnership comprises:

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**'This report was prepared by Professor George Tanewski on behalf of the IPA-Deakin SME Research Partnership.**

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02 June, 2016

Small Business Entities and Industry Concessions Unit

Individuals and Indirect Tax Division

The Treasury

Langton Crescent

PARKES ACT 2600

Email: VentureCapital@TREASURY.GOV.AU

Dear Sir/Madam

**Encouraging venture capital investment in FinTech**

We welcome the opportunity to comment on this important proposal to encourage venture capital investment in the FinTech sector.

The IPA Deakin University SME Research Partnership has been very supportive of policy to develop the venture capital sector in Australia, which we believe to be underdeveloped. Our policy recommendations can be found in the Small Business White Paper launched in 2015,

<https://www.publicaccountants.org.au/whitepaper>

In order to assess which activities may be considered ‘ineligible’ we have compared a selection of definitions and activities of FinTech from various jurisdictions around the world.

Our submission provides recommendations on modifications that should be made to the definition of ‘ineligible activities’ in the *Income Tax Assessment Act 1997*. This will have the effect of capturing a broader range of financial activities which have been impacted by the application of technology.

Accordingly, this range of FinTech activities (see Appendix B) suggest that the ineligible activities for venture capital investment currently listed in Section 118.425 of the *Income Tax Assessment Act 1997* is out of date. Appropriate amendments will ensure that the legislation reflects market developments and Government policy to encourage venture capital investment in the FinTech sector.

If you would like further information or to discuss any aspect of our submission then please don’t hesitate to contact Vicki Stylianou, on either [vicki.stylianou@publicaccountants.org.au](mailto:vicki.stylianou@publicaccountants.org.au) or on 0419 942 733.

Yours faithfully



Vicki Stylianou

IPA Executive General Manager, Advocacy & Technical

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**Changing the Criteria of ‘Ineligible Activities’ in the *Income Tax Assessment Act 1997***

The IPA is pleased to provide a submission to Treasury on its consultation - “*Ensuring that venture capital tax concessions are available for investment in startup FinTech, banking and insurance activities”*. Our submission provides some recommendations on modifications that should be made to the Income Tax Assessment Act’s 1997 definition of ‘ineligible activities’.

1. **Background**

According to the Australian Private Equity & Venture Capital Association Limited 2015 Yearbook[[1]](#footnote-1), total venture capital investment activity in Australia decreased by 58.18% [[2]](#footnote-2)to $223.89m in the 2015 financial year from $535.35 million in the previous financial year, indicating that venture capital investment has become less attractive in Australia. This significant decrease in venture capital investment provides some vindication to the Government’s introduction of venture capital tax concessions for startups in FinTech, particularly startups in insurance and finance related activities, from 1 July 2016 as a means of stimulating innovation and growth in these sectors and by making venture capital investment more responsive and flexible.

Venture capital is well developed in some of the world’s financial markets, particularly in the US, and is an important source of funds for dynamically growing small and young firms (Gompers and Lerner 2001)[[3]](#footnote-3). Governments around the world view venture capital investment as an important tool for promoting economic and industrial development (Callagher, Smith, and Ruscoe 2015) [[4]](#footnote-4). This is because venture capital is widely believed to contribute to the competitive strength of the US and other economies by promoting the development of innovative start-ups (Hellmann and Puri 2000)[[5]](#footnote-5). Empirical research finds venture capital investors are better able to manage risky investments compared to other investors as they generally have specialized knowledge and experience of organizational, operational, and industry issues related to the firms they are investing in (Gompers and Lerner 2001; Callagher, Smith, and Ruscoe 2015).

Given the importance of venture capital investment for stimulating innovation and growth in the economy, particularly among startup firms, we are of the view that some modifications are required to the *Income Tax Assessment Act 1997[[6]](#footnote-6)*, particularly alterations related to the ineligibility criteria as currently outlined in *Section 118.425: Meaning of eligible venture capital investment--investments in companies.* The rationale for making changes to the ineligibility criteria is borne out by our synthesis of the different explanations provided on what comprises FinTech and the various activities that are usually associated with FinTech in the banking and financial industries in different countries. As these explanations and activities of FinTech overlap with some of the activities that are currently listed in the ineligibility criteria, it is no longer sensible to exclude these activities from venture capital investment in Australia.

1. **What Constitutes Financial Technology: Towards a Definition of FinTech**

A worldwide search of the literature and various public and private sector websites indicates there is some variation to what constitutes Financial Technology (FinTech). This variation also applies to the range of activities that make up FinTech in the banking and financial services industry. However, these apparent differences are context-specific, suggesting that FinTech is primarily technology-focused, applying a wide range of techniques and innovations in order to significantly transform the banking and financial services sector.

In Australia, Treasury refers to FinTech broadly as innovation activities that “… stimulat[e] technological innovation so that financial markets and systems can become more efficient and consumer focused’[[7]](#footnote-7). In the UK, however, HM Treasury (2016) associates FinTech specifically with high growth firms and refers to it as ‘high-growth organisations combining innovative business models and technology to enable, enhance and disrupt financial service’[[8]](#footnote-8), while the EU broadly describes FinTech as “… the application of technology within the financial industry, covering a wide range of activities’[[9]](#footnote-9), without trying to specifically narrow down FinTech to a set of activities within the banking and financial industry. Meanwhile, the Hong Kong Steering Group on Financial Technologies report refers to FinTech as denoting ‘… the application of IT within financial services, above all, the rise of the internet as a means of lowering barriers both to entry and costs within the industry’[[10]](#footnote-10)[[11]](#footnote-11), whereas Singapore sees ‘FinTech as fundamentally transforming the financial industry and it encompasses a wide range of technologies’[[12]](#footnote-12). In Germany, the Federal Financial Supervisory Authority (BaFin) describes FinTech as comprising both ‘financial services’ and ‘technology’, and states that ‘FinTechs are commonly understood to be young undertakings that provide specialised and in particular customer oriented financial services using technology based systems’[[13]](#footnote-13). In Switzerland, the Financial Market Supervisory Authority (FINMA) refers to FinTech companies as those ‘companies tapping into the potential of digital know-how for the financial industry’[[14]](#footnote-14). The World Economic Forum released a report in 2015 highlighting the importance of financial innovation, defining FinTech as ‘…the usage of technology and innovative business models in financial services’[[15]](#footnote-15).

In summary, the above explanations of financial technology suggest that FinTech is primarily technology-focused, applying a wide range of techniques and innovations designed to either improving existing services or disrupting current business models used in the banking and financial services sectors.

1. **Ineligible Activities in the *Income Tax Assessment Act 1997***

Following the above discussion, our review indicates that FinTech is primarily made up of a range of technology-focused activities. These include, but are not exclusive, to the following range of activities:

* electronic and internet banking;
* digital payments, credit and lending systems;
* insurance;
* retail investment, pensions, and investment management;
* wholesale banking and capital markets;
* digital (virtual) currencies;
* P2P lending platforms and crowdfunding;
* cloud computing and big data;
* e-trading platforms and algorithmic trading;
* blockchains and distributed ledger systems;
* operations and risk management;
* data security monetisation;
* customer interface; and
* other finance-related infrastructure.

Accordingly, this range of FinTech activities (see Appendix B) suggest that the ineligible activities for venture capital investment currently listed in Section 118.425 of the *Income Tax Assessment Act 1997* is out of date. The Act includes a number of finance activities as ineligible such as banking, providing capital to others, leasing, factoring; securitisation and other activities such as insurance, construction, and making investments, that are directed to deriving income in the nature of interest, rents, dividends, royalties or lease payments[[16]](#footnote-16). We recommend that these ineligible activities be removed from the Act as they are no longer applicable and are contrary to the intended purpose of venture capital investment for start-ups in FinTech.

**Appendix A: Comparison of FinTech “Definitions” by Jurisdiction**

|  |  |
| --- | --- |
| **Treasury, Australia** | FinTech stimulates technological innovation so that financial markets and systems can become more efficient and consumer focussed. |
| **Treasury, UK** | FinTech refers to high-growth organisations combining innovative business models and technology to enable, enhance and disrupt financial services. |
| **Hong Kong** | FinTech is the application of IT within the financial services industry, above all, it is due to the growth of the internet as a means of lowering barriers both to entry and costs within the industry. |
| **Singapore** | FinTech is fundamentally transforming the financial industry by encompassing a wide range of technologies. |
| **EU** | FinTech is the application of technology within the financial industry, covering a wide range of activities. |
| **Germany** | FinTech is commonly understood to be young undertakings that provide specialised and, in particular, customer oriented financial services using technology based systems. |
| **Switzerland** | FinTech are companies that tap into the potential of digital know-how for the financial industry. |

**Appendix B: Comparison of FinTech Activities by Jurisdiction**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **FinTech Activities by Jurisdiction** | | | | | | |
| **Treasury, Australia** | **Treasury, UK** | **Hong Kong** | **Singapore** | **EU** | **Germany** | **Switzerland** |
| * Peer-to-peer lenders * Primary banking accounts and payments | * Credit and lending * Banking and payments | * Peer-to-peer financing platforms | * P2P lending platforms | Financing, payments, and infrastructure | * Automated financing advice | **N/A** |
| * Insurance | * Insurance | **N/A** | **N/A** | **N/A** | * Insurance | **N/A** |
| * Mobile payments | **N/A** | * Payments and infrastructure | * E-trading platforms, algorithmic trading * Digital payments | **N/A** | * Payment transactions and giro business | * Electronic payment services |
| * Investment management | * Investment management, wholesale banking and capital markets * Retail investment and pensions | * Financial product investment and distribution platforms | **N/A** | **N/A** | **N/A** | **N/A** |
| * Digital currencies * Crowdfunding * Capital markets | **N/A** | * Big data and data analytics to support both front-office and back-office operations * Customer interface * Cybersecurity and data security monetisation * Digital payment and remittance * Distributed ledger application to new asset classes and processes * Operations and risk management * Security technology | * Blockchains and distributed ledgers systems * Cloud computing and big data * Crowdfunding * Digital currencies | * Customer interface * Data security and monetization * Operations and risk management | * Crowdfunding * Virtual currencies | * Crowdfunding * Virtual currencies |

1. Prior four year venture capital investment totals are $280.31m in FY2011; $153.18m in FY2012; $143.69m in FY2013; $535.35m in FY2014. Australian Private Equity and Venture Capital Association (AVCAL). (2015). 2015 Yearbook - Private Equity and Venture Capital Activity Report. <https://www.avcal.com.au/documents/item/1167> [↑](#footnote-ref-1)
2. The growth rates for venture capital investment activities are -16.29% in FY2010, 46.47% in FY2011, -45.35 in FY2012, -6.20% in FY2013, 272.57% in FY2014, and -58.18% in FY2015 respectively. [↑](#footnote-ref-2)
3. Gompers, P. and Lerner, J. (2001). The Venture Capital Revolution. The Journal of Economic Perspectives 15(2): 145-168. [↑](#footnote-ref-3)
4. Callagher, L. J., Smith, P., and Ruscoe, S. (2015). Government Roles in Venture Capital Development: a Review of Current Literature. *Journal of Entrepreneurship and Public Policy* 4(3): 367 – 391. [↑](#footnote-ref-4)
5. Hellmann, T. and Puri, M. (2000). The Interaction between Product Market and Financing Strategy: The Role of Venture Capital. *The Review of Financial Studies* 13(4): 959-984. [↑](#footnote-ref-5)
6. ### Income Tax Assessment Act 1997 - Section 118.425.

   [↑](#footnote-ref-6)
7. Australian Treasury (2016). Backing Australian FinTech. Canberra: Commonwealth of Australia March 2016. [↑](#footnote-ref-7)
8. HM Treasury and EY. (2016). UK FinTech on the Cutting Edge: An Evaluation of the International FinTech Sector. United Kingdom. [↑](#footnote-ref-8)
9. EU Financial Centres Roundtable. (2016). EU FinTech Regulatory Framework. Spain. [↑](#footnote-ref-9)
10. Hong Kong Special Administrative Region Government. (2016). Report of the Steering Group on Financial Technologies. Hong Kong. [↑](#footnote-ref-10)
11. KPMG, DLA Piper, Thomson Reuters, and Hong Kong Internet Finance Council. (2015). Making Hong Kong a FinTech Centre: Innovating Business in Asia. Hong Hong. [↑](#footnote-ref-11)
12. Monetary Authority of Singapore. (2016). FinTech: Harnessing its Power, Managing its Risks. Singapore. [↑](#footnote-ref-12)
13. Federal Financial Supervisory Authority (BaFin). (2016). FinTechs: Young IT Companies on the Financial Market. Federal Ministry of Finance, Germany. [↑](#footnote-ref-13)
14. Swiss Financial Market Supervisory Authority (FINMA). (2016). Annual Report 2015. Switzerland. [↑](#footnote-ref-14)
15. World Economic Forum. (2015). Global Agenda Council on the Future of Financing & Capital: The Future of FinTech- A Paradigm Shift in Small Business Finance. Switzerland. [↑](#footnote-ref-15)
16. Income Tax Assessment Act 1997 - Section 118.425, 13 Ineligible Activities. [↑](#footnote-ref-16)