TD 2025/3EC - Compendium

Australian Government
Australian Taxation Office

Public advice and guidance compendium – TD 2025/3

Relying on this Compendium

This Compendium of comments provides responses to comments received on Draft Taxation Determination TD 2025/D1 *Income tax: application of Part IVA of the Income Tax Assessment Act 1936 to certain early stage innovation company investment arrangements*. It is not a publication that has been approved to allow you to rely on it for any purpose and is not intended to provide you with advice or guidance, nor does it set out the ATO's general administrative practice. Therefore, this Compendium does not provide protection from primary tax, penalties or interest for any taxpayer that purports to rely on any views expressed in it.

Summary of issues raised and responses

All legislative references in this Compendium are to the *Income Tax Assessment Act 1936*, unless otherwise indicated.

Issue number	Issue raised	ATO response
1	**Commercial structure** Structures with the following features are distinguished from the arrangement described in the draft Determination: • The loans are fully recourse to investors. • Funds are kept by financier for prudent capital management, not to be returned to investors. • No circular financing, capital return or share buy-back involved. • Start-up has no contractual obligation to return funds to investors. As such, there was no dominant purpose of obtaining a tax benefit.	We will not provide comment on arrangements that purportedly differ from that described in Taxpayer Alert TA 2024/1 *Early stage investor tax offset claimed using circular financing arrangements* and the final Determination. Arrangements of concern may include some or all the features as described and it is open for investors and start-ups to engage with us for further clarification.

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2	**Alignment with early stage innovation company (ESIC) legislative purpose** The ESIC regime was legislated to address capital access challenges faced by early-stage start-ups. Arrangements aligned to this goal: • channel capital into qualifying ESICs • support innovation and employment • apply best practice investment governance. Denial of a tax offset in these circumstances defeats the legislative purpose of the ESIC regime. The ESIC program was introduced to inspire innovation. The scheme is working as intended to create jobs, foreign investment and export dollars for Australia.	TA 2024/1 describes and sets out concerns with arrangements which appear designed to *artificially* meet the conditions for claiming the maximum ESIC tax offset, allowing individuals to benefit with minimal (if any) risk on their investment, and the final determination is that Part IVA is likely to apply to arrangements similar to that described in TA 2024/1. This is not inconsistent with the legislative purpose of the ESIC regime.
3	**Genuine financial risk** The concerns in the draft Determination regarding lack of financial exposure are not applicable where: • Investors remain fully liable for their loan. • No guarantee, indemnity or pre-arranged offsetting mechanism was in place. • The investor remained exposed to both equity and debt risk.	We will not provide comment on arrangements that purportedly differ from that described in TA 2024/1 and the final Determination. Arrangements of concern may include some or all the features as described and it is open for investors and start-ups to engage with us for further clarification.
4	**Application date should be prospective only** Applying the new interpretations retrospectively would undermine certainty and fairness, particularly in an area (Part IVA) where subjective assessments dominate. Making the date of effect prospective is a compromise that would eliminate a lot of the fear and time wasting that are anticipated out of this Determination.	We consider that the law should apply both before and after the issue date of the final Determination. We do not consider that there are relevant factors for the view to be applied prospectively.

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5	**Only a 2-year amendment period applies** The threshold in paragraph 170(1)(e) is whether it is reasonable to conclude that the scheme was entered into for a dominant purpose of obtaining a scheme benefit. Given the investor's full recourse liability, long-term equity exposure, and commercial motivations, such a conclusion would not be reasonable on the facts. As such, the standard 2-year amendment period should apply under table item 1 of subsection 170(1). This interpretation is consistent with case law that warns against mechanically applying the 4-year rule simply because Part IVA is invoked.	Where it is reasonable to conclude, for the purposes of section 177D, that a person - or one of the persons - who entered into or carried out a scheme did so for the dominant purpose of enabling an individual to obtain a tax benefit, it will generally follow that the scheme was entered into or carried out for the sole or dominant purpose of the individual obtaining a scheme benefit in relation to income tax for that year. In the context of arrangements to which the final Determination applies, we consider that this conclusion follows. Consequently, the 2-year amendment period in subsection 170(1) will generally not apply to individuals in this circumstance.
6	**The factors under section 177D** Criteria a) and b): A platform that asks investors to invest in a company and, if needed, borrow some money to do so, offers start-up companies with a plan, so the legal form and the substance of the transaction is the same or simpler than most other start-up companies. Criterion c): The evidence is that taxpayers leave their investment until the last minutes so timing definitely indicates that tax planning plays a role. It is unclear how much weight is put on this criterion when most legitimate tax measures are promoted and executed towards the end of the financial year. Criterion d): Most start-up investments are lost and lead to capital losses that would be 50% deductible. So a taxpayer at a 40% marginal tax rate would get a 20% benefit normally but now gets a 20% ESIC benefit instead. Without this arrangement, taxpayers investing in a failed start-up would get about the same tax benefit. ESIC is better for timing of the benefit and for the few successful start-ups. Criterion e): Many investors have agreed that the full tax benefit be applied to the year one budget so their benefit depends entirely on the success of their ESIC. Founders	We will not provide comment on arrangements that purportedly differ from that described in TA 2024/1 and the final Determination. Arrangements of concern may include some or all the features as described and it is open for investors and start-ups to engage with us for further clarification.

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	should budget conservatively in year one so that it leads to a small net financial benefit to investors. The bigger objective is for the founder to prove some traction and to create much bigger start-up returns along with much greater risk to their investors. Criteria f) and g): A large reason that early stage start-ups are commonly funded by family and friend investors is that this group wants to assist the founder to achieve their dreams. It would be funny if these common funding drivers were considered irrelevant and that tax was the dominant purpose.	
7	**The companies involved in the scheme are not mere shams for tax avoidance purposes** This assumption is incorrect and overlooks the real impact that start-ups are having on people's lives and the Australian economy.	Whilst there may be factual circumstances in which a start-up company is shown to be a mere pretence and sham, neither TA 2024/1 nor the final Determination make such a generalisation. The statement at paragraph 8 of TA 2024/1 – raising additional concern about arrangements also being promoted to start-up companies seeking seed capital – does not imply that all such companies are illegitimate. The potential application of Part IVA presently does not turn on whether the start-up company is itself genuine, but on a holistic assessment of the entire arrangement and the purposes of those who entered into or carried out a scheme.
8	**Milestone-based fund distribution arrangement is a commercial practice** A milestone-based fund distribution arrangement is a commercial practice as: • the deposit arrangement serves a capital preservation and governance purpose, common in venture finance and start-up grants • it provides investor confidence in governance and capital allocation • it preserves capital during the 'valley of death' phase common to early-stage ventures.	The potential application of Part IVA presently does not turn on any singular feature of the arrangement described in TA 2024/1, but on a holistic assessment of the entire arrangement and the factors set out in subsection 177D(2). It is open for investors and start-ups to engage with us for further clarification on their specific circumstances.

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9	**Other comments** Many start-ups are a legitimate business focused on genuinely developing innovation. There are models that are useful in getting funding and managing a start-up's financial affairs.	The potential application of Part IVA presently does not turn on whether the start-up company is itself legitimate, but on a holistic assessment of the entire arrangement and the factors set out in subsection 177D(2). It is open for investors and start-ups to engage with us for further clarification on their specific circumstances.