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# **Entrepreneurship and Income Tax: What was the Past Like – and Travelling into the Future**

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## **Abstract**

On 7 December 2015, Prime Minister Turnbull released an Innovation Statement promising increased tax breaks to support innovation and entrepreneurship. This followed two years of attention paid to small business tax policy by the Government under Prime Minister Abbott, including in the 2015 budget, \$5.5 billion of expenditure on tax concessions for small businesses. This paper aims to unpack the various proposals, asking the fundamental question, what is entrepreneurship and what are the goals of these tax policies? Is entrepreneurship worth supporting and are these various types of tax concessions or incentives the way to go about it? More broadly, how, if at all, do these tax measures for entrepreneurship fit into the broader context of business taxation in a global economy and the challenge of business tax reform in Australia that we may expect be addressed by the tax White Paper?

## **Keywords**

Entrepreneurship, small business, innovation, company tax, tax incentives, tax reform, globalization

## Contents (DRAFT)

<b>1. Introduction</b> .....	<b>1</b>
<b>2. The Innovation Agenda</b> .....	<b>2</b>
2.1. Angel investor tax credit.....	3
2.2. VCLP reforms .....	3
2.3. Easier access to carryforward company losses .....	4
2.4. Intangible asset depreciation .....	4
<b>3. What is entrepreneurship?</b> .....	<b>4</b>
3.1. Origins: A Frenchman who does something for profit .....	5
3.2. Creative destruction and productive entrepreneurship.....	6
3.3. A working definition of “entrepreneur” .....	8
3.4. Case studies .....	9
3.4.1 Triangl Bikinis.....	9
3.4.2 Emma’s 3DPrintSmart business .....	10
3.4.3 CSL’s biotech factory in Switzerland.....	12
<b>4. What do we want from entrepreneurship?</b> .....	<b>12</b>
4.1. Jobs .....	13
4.2. Innovation .....	14
4.3. What are the impediments to entrepreneurship? .....	16
4.3.1 Not enough innovation .....	17
4.3.2 Lack of capital.....	17
4.3.3 Risk.....	18
4.4. Proxies for entrepreneurship in tax policy .....	19
4.5. Planning, behaviour and tax arbitrage .....	20
4.5.1 Effect of tax rates.....	21
4.5.2 Compliance and regulatory cost .....	22
<b>5. Design of Australian tax incentives for entrepreneurs</b> .....	<b>23</b>
5.1. Reducing the cost of wages: Employee shares and options.....	23
5.2. A lower tax rate on entrepreneurial profits .....	23
5.3. Lower tax rate on capital gains of owners or investors .....	24
5.3.1 CGT discounts and exemptions.....	24
5.3.2 PDFs.....	24
5.3.3 VCLPs.....	25
5.3.4 Early Stage VCLPs .....	27
5.4. Expensing or accelerated depreciation of business assets.....	28
5.5. Losses and risk .....	29
<b>6. The bigger picture: Benchmarks and tax policy goals</b> .....	<b>29</b>
6.1. Benchmarks for tax policy .....	31
6.1.1 Income tax .....	31
6.1.2 Expenditure (consumption) tax .....	31
6.1.3 Economic rent and cash flow taxes.....	32
6.2. Design of tax incentives .....	32
<b>7. Conclusion</b> .....	<b>36</b>
<b>Appendix</b> .....	<b>40</b>
<b>References</b> .....	<b>42</b>



*“There’s never been a more exciting time to be Australian.”*

Malcolm Turnbull, 7 December 2015<sup>1</sup>

*“It is necessary to consider not merely the requirements of the revenue, but also the incidence of the tax, so that the economic equilibrium may be disturbed as little as possible. Australia is a very rich country, her production per capita being very great; perhaps the greatest in the world. ... A country’s productivity is the measure of its labour force, its energy and its resources. The productivity of labour depends mainly upon two things: the amount of capital available and the manner in which it is being used, and the efficiency of the labour. At this juncture it is of the utmost importance that we shall do nothing to discourage enterprise...”*

Billy Hughes, 18 August 1915<sup>2</sup>

## **1. Introduction**

On 7 December 2015, our ever-positive Prime Minister Turnbull released the National Innovation and Science Agenda which included tax breaks to support innovation and entrepreneurship, among a raft of other policies (Australian Government 2015b). This followed two years of attention paid to small business tax policy by the Government under Prime Minister Abbott, including in the 2015 budget, \$5.5 billion of expenditure on tax concessions for small businesses and, previously, the reinstatement of concessions for employee stock options and share remuneration.

In spite of the excitement attending the Prime Minister’s Innovation Statement, this policy attention both to the SME sector and to tax concession for innovation is not new, either in the Australian context, in comparable countries or in institutions such as the OECD. Indeed, we regularly return to these issues of how to encourage entrepreneurship and innovation. However, the issues seem more than ever on the agenda, in the current era of low growth and in the context of G20 goals to increase growth. Recently, the OECD released a comparative report on taxation of SMEs in OECD and G20 countries, in

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<sup>1</sup> Australian Government 2015b, p. 1.

<sup>2</sup> Commonwealth Parliament, Hansard, House of Representatives, 18 August 1915, p. 5843.

response to the priority given to fostering development of the SME sector under the Turkish G20 Presidency (OECD 2015a). The OECD has also built a database that monitors SME and entrepreneurial access to finance including debt and equity, as access to finance has been identified as a key constraint on the SME sector (OECD 2015b). Academic researchers are also interested. The most recent NYU/UCLA Tax Policy Symposium held in October 2015 focused on tax and entrepreneurship,<sup>3</sup> while the forthcoming conference of the International Institute of Public Finance in 2016 will be on Entrepreneurship, Innovation and Public Policy, with a particular focus on tax and intellectual property regimes.<sup>4</sup>

This paper aims to unpack the latest Australian policies and proposals and to analyse them against benchmarks for tax policy; the current tax rules affecting entrepreneurs; and (some of) the goals, and effects, of past policy and law reform. Underlying all of these proposals are two assumptions: First, that entrepreneurship, and in particular entrepreneurial SMEs and start-ups, are key engines of economic growth; and second, that government policy can incentivise entrepreneurial activity through the tax system. The paper first examines the literature to identify what is an entrepreneur and what might be the reasons to support entrepreneurship. It then outlines Australia's tax concessions or incentives for entrepreneurship and considers what these aim to achieve and likely success, in a broader tax policy context.

## **2. The Innovation Agenda**

Although the Re:Think tax reform white paper process (Treasury 2015) is continuing, in December 2015 the Government presented some tax incentives for entrepreneurs that aim to “promote investment in innovative, high-growth potential startups by providing concessional tax treatment for investors”.<sup>5</sup> The tax measures summarised below are proposed in addition to a suite of other grants and funds including the CSIRO Innovation fund; Biomedical Translation Fund; Incubator Support Program; a global innovation strategy to establish “landing pads” for Australians in Silicon Valley, Tel Aviv and elsewhere;

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<sup>3</sup> Full web stream available at <https://uclalaw.hosted.panopto.com/Panopto/Pages/Viewer.aspx?id=425007c3-2834-43b0-bfc3-0e07547d75bb> .

<sup>4</sup> International Institute for Public Finance, <http://iipf2016.com/> .

<sup>5</sup> Innovation Statement Fact Sheets, Tax incentive for early stage investors (December 2015).

domestic research infrastructure and University spending; regulatory reforms for insolvency and employee share schemes; and other measures.

### **2.1. Angel investor tax credit**

This is a 20% non-refundable tax offset on investments, capped at \$200,000 per investor per year. The angel investor tax credit will be available effective 1 July 2016 for investments in companies that:

- undertake an eligible business (scope to be determined in consultation with industry)
- were incorporated during the last three income years
- are not listed on any stock exchange
- have expenditure and income of less than \$1 million and \$200,000 in the previous income year respectively.

Based on details so far, there is no requirement as to location of the business. The tax incentives for angel investors are estimated to cost \$3 million in the first year and as much as \$51 million in 2017-18 and 2018-19. The Innovation Statement appear generous, the estimated revenue cost from most of these tax measures is stated to be low or unquantifiable (Australian Government 2015b, Appendix). Over the forward estimates, the total cost is estimated at \$200 million.

### **2.2. VCLP reforms**

The government seeks to attract more investment into Venture Capital Limited Partnerships (VCLPs) and Early Stage VCLPs (ESVCLPs) by increasing the tax concessions effective 1 July 2016:

- Partners in a new ESVCLP will receive a 10% non-refundable tax offset on capital invested during the year;
- Maximum fund size for new ESVCLPs will be increased from \$100 million to \$200 million; and
- ESVCLPs will no longer be required to divest from a company when its value exceeds \$250 million.

More details on VCLPs are below. The government also proposes to relax the investment activity and investor eligibility requirements for both types of venture capital fund. The VCLP

and company loss measures are stated as non-quantifiable and the intangible asset depreciation measure is estimated at \$20 million in 2017-18 and \$60 million in 2018-19.

### **2.3. Easier access to carryforward company losses**

The Government proposes to “relax” the company loss carryforward “same business test” (SBT) to allow businesses to use prior year losses when they have entered into new transactions or business activities. It proposes a “new and more flexible ‘predominantly similar business test’”, available for a business that, “while not the same, uses similar assets and generates income from similar sources.”

### **2.4. Intangible asset depreciation**

Currently intangibles such as copyright and patents are depreciable on a straight line basis applying statutory effective lives (e.g. 20 years for copyright). The government proposes to allow businesses to “self-assess the tax effective life of acquired intangible assets that are currently fixed by statute. This will better align tax treatment of the asset with the actual number of years the asset provides an economic benefit.”

I return to discuss these reforms and other features of Australia’s tax system for entrepreneurs below. First, this paper explores the concept of entrepreneurship.

## **3. What is entrepreneurship?**

A common starting point of the discussion is “entrepreneurship good, tax bad”.<sup>6</sup> What is entrepreneurship? Why is it “good”? More specifically, what does the Government think entrepreneurship is, and what does the Government think it is doing in pursuing tax incentives for entrepreneurship?

Is entrepreneurship fundamentally about start-ups and the activities of individual entrepreneurs? Is it about small businesses, or about new businesses, or about growing businesses? How does analysis and policy about entrepreneurship relate to firms across the SME sector, from very small to those with a turnover of \$100 million a year? Why not large businesses? Are some kinds of entrepreneurship more valuable than others? More

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<sup>6</sup> As Professor Eric Zolt said recently in his opening remarks to the NYU/UCLA symposium, October 2015, *Ibid.*



broadly, is there a relationship between entrepreneurship and increased productivity or faster rates of economic growth? If so, what drives this relationship? More fundamentally, do we actually want to *subsidise* entrepreneurship relative to other market activities, or do we seek to establish a neutral or level playing field by addressing market failure (thereby operating on various assumptions about that market failure) so that entrepreneurship can contribute to broader social and economic wellbeing, produced by positive spillovers.

This section addresses these questions by surveying what the academic literature has said about entrepreneurship and seeking to identify the most important elements for economic policy in general, and tax policy in particular. It briefly describes the field of entrepreneurship research, as it has developed since it was first studied by early economists in the 18th century. The arguments in the literature to support encouraging an entrepreneurial economy, or productive entrepreneurship, are considered.

### **3.1. Origins: A Frenchman who does something for profit**

The literal English translation of entrepreneur, is the 'one who undertakes' (from *entreprendre*). In 1755, Irish-French political economist, Richard Cantillon, proposed that the entrepreneurs' primary role was arbitrage. He stated, 'entrepreneurs are the prime directors of resources', who 'pay a fixed price for [goods] at the place where they are purchased to resell wholesale or retail at an uncertain price' (Cantillon 2010, 73–4). The difference between the prices paid and received for the goods represented entrepreneurs' profit. Cantillon believed profit was entrepreneurs' primary motivation.

In 1803, French economist Jean-Baptiste Say described entrepreneurs as those who shift 'economic resources out of an area of lower and into an area of higher productivity and greater yield' (Say, cited in Drucker 1985, 21). Entrepreneurship was 'the application of acquired knowledge to the creation of a product for human consumption' (Say 2010, 176). Say recognised the production of new goods and services creates a degree of uncertainty, insofar as entrepreneurs cannot predict demand and may not know whether all of the resources they need for production may be available. Like Cantillon, Say recognised that the entrepreneur takes upon him or herself 'the immediate responsibility, risk, and conduct of a concern of industry, whether upon his own or a borrowed capital' (Say 2010, 128) ... 'in a way that reproduces it, and with that profit' (Say 2010, 1320). In short, both early economists realised that entrepreneurs take a risk to develop new products because of the potential reward of profit.

### **3.2. Creative destruction and productive entrepreneurship**

In the early 20<sup>th</sup> century, Harvard economist Joseph Schumpeter conceptualised entrepreneurship as having broader economic implications. He described it as an innovative activity, whose purpose was development, because it involves “the carrying out of new combinations” of resources, to bring new products to market (Schumpeter 1911, 1934, 75). The creation of new products, services or industries is what leads to demise of older, established ones, which Schumpeter termed “creative destruction” in the market. Schumpeter described creative destruction at length, in a later work (Schumpeter 1994, 83):

The opening up of new markets, foreign or domestic, and the organizational development from the craft shop and factory to such concerns as US Steel illustrate the same process of industrial mutation---if I may use that biological term---that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one. This process of Creative Destruction is the essential fact about capitalism. It is what capitalism consists in and what every capitalist concern has got to live in.

Schumpeter saw entrepreneurship as a kind of economic development, driven from within, as opposed to change which is forced upon economies from external forces (Swedberg 2006, 24–5). Entrepreneurs are leaders whose beliefs are strong enough to resist potential opposition to their ideas for change. They also lead by displaying the tenacity to carry out new combinations of existing resources, or new ways of doing things (Swedberg 2006, 29). By discussing entrepreneurs' role in development, Schumpeter introduced a dynamic element into economic analysis, to complement the tools of rational choice, market equilibrium and marginal utility in the static approaches of neoclassical economics.

If creative destruction is about economic development then, contrary to some popular uses of the term, it is not a zero-sum game and it can contribute to broader societal and economic wellbeing. Entrepreneurs in pursuit of profit extract economic value from their activities, and may rise in their social standing if they become wealthy as a result, while their ventures may cause less innovative firms to lose out and even close. While these effects on existing firms are negative consequences of entrepreneurship, and perhaps imply a zero sum game (the new ‘winners’ and the old ‘losers’ net out), Schumpeter argued that entrepreneurial innovation, generally through entrepreneurs starting new enterprises, should lead to the adoption of better methods of production, higher quality goods and services, thereby contributing to economic growth and development. The

success of an innovation in the market was a test of whether it was valuable, not only for the entrepreneur, but society as a whole. Entrepreneurship should generate a social surplus as well as an economic one.

While Schumpeter believed entrepreneurship had a broader social purpose, he nonetheless agreed with his predecessors that profit---that is, the surplus in excess of the cost to commercialise innovations---was what primarily motivated entrepreneurs. He argued that entrepreneurs, rather than capitalist investors and firm managers, bore the risk of commercialising an innovation, such that entrepreneurial profit 'the premium put upon successful innovation' (Schumpeter 1939, 55). Schumpeter argued that entrepreneurs cease to be entrepreneurial when they stop innovating, whereupon they become managers of an established enterprise. Marking out a particular sphere of activities, in which entrepreneurs had special capabilities, was an important theoretical insight.

Schumpeter also proposed a model of the entrepreneurial mind-set. He thought the capacity to seize an opportunity defined the entrepreneurial moment and believed entrepreneurial decisions were "novel intuitions". Since Schumpeter first proposed it, the idea that entrepreneurs think differently has become one important way in which analysts seek to differentiate entrepreneurship from other business activities. While Schumpeter highly valued individual entrepreneurs in spearheading disruptive change, in his framework the most important feature is the assembly of new combinations in the market.

Austrian-school economist Israel Kirzner, now considered, with Schumpeter, one of the most influential entrepreneurship scholars (Shockley and Frank 2011), flipped the focus of entrepreneurship from bringing new products or combinations to market, to discovering and exploiting new opportunities in the market. Kirzner saw entrepreneurs as "decision-makers, whose entire role arises out of his alertness to hitherto unnoticed opportunities" (Kirzner 1973, 38–9). The entrepreneur does not (necessarily) develop something new; instead, their capability is to discover opportunities, or interpret market information, before anyone else can do so, and thereby exploit this opportunity. Entrepreneurs' alertness to opportunities that others have overlooked is what creates the space for entrepreneurial activity (Kirzner 1973, 26, 116; 1982, 150). Entrepreneurial discovery takes place in situations of uncertainty---that is, unknown probabilities---rather than in situations where risks are well-known---that is, known probabilities (this is known as Knightian uncertainty: (Knight 2006)). This increases risk for the entrepreneur and investors.

However, it is important to note that for both Kirzner and Schumpeter, the entrepreneur is not the same as the capitalist (who invests capital to derive a return from a particular activity or resource). Kirzner (1973, 16, 48) believed entrepreneurial discovery does not require capitalist investment. This is because discovering new opportunities is free. In fact, Kirzner argued pure entrepreneurship is separate from ownership of existing assets. This suggests that entrepreneurs have a different role in the economy to capitalist investors. Nonetheless, as is discussed further below, capital constraint or lack of investment has become a key issue in contemporary discussion about entrepreneurship. Many tax incentives are aimed at increasing available capital for startups or firm growth, or about making access to capital investment easier.

Kirzner (1997a, 62, 70), like Schumpeter, saw a broader economic role for entrepreneurship. When an entrepreneur spies an opportunity to buy goods and services at low prices, and then sell them again at high prices, thereby making a profit this competitive market activity is what moves the market from disequilibrium towards equilibrium. Kirzner's entrepreneurs make profit from arbitrage in the market, and their special capability, in a sense, is to find that arbitrage opportunity. Once an entrepreneurial transaction is complete, the profit-making opportunity deteriorates. According to Kirzner (1982, 154), the scope for entrepreneurial activity is related to the operation of the market across time. This raises the question, if entrepreneurship is just another way of describing the core activity of participants in a market as it changes dynamically over time, shouldn't this be taxed? If we are to tax returns to capital at all – raising the bigger question about interaction of taxes and markets (“taxes bad”) - shouldn't tax be imposed on the speculative or opportunistic returns to arbitrage opportunities obtained by the entrepreneur? I return to the issue of arbitrage again, in particular the interaction of tax planning with market arbitrage, below. Interesting questions arise, first, as to why we may seek to provide tax subsidies for entrepreneurs simply to take advantage of arbitrage opportunities in the market; and second, as to how the tax system affects market arbitrage.

### **3.3. A working definition of “entrepreneur”**

In recent decades there has been considerable research about entrepreneurial behaviour in a variety of fields including business, psychology and strategic management. Following another Austrian-school economist, Mises, Kirzner believed entrepreneurship is present in all fields of human endeavour. Opportunities could be discovered, and market forces

employed to achieve ends, by any person, or public or private organisation (Shockley and Frank 2011, 15). Like Schumpeter, Kirzner considered that the role of entrepreneurship in the economy and society is more important than the characteristics and instrumental activities of individual entrepreneurs. While his or her psychological and personal qualities enable the entrepreneur to discern price differentials in an open-ended, uncertain world, Kirzner (1999, 12) argued the contribution entrepreneurship makes to the sequence of discoveries, which drive market processes, is independent of these individuals' qualities.

Recent scholarship has aimed to identify how opportunities arise, what makes an entrepreneur, behaviours, strategies, practices and resources needed for successful entrepreneurship (see surveys in Wang and Jessup 2014; Shane and Venkataraman 2000). This literature has extended the analysis of entrepreneurs to encompass non-profit and governmental contexts as well as the market. However, this paper focuses on the notion of the entrepreneur in the marketplace.

It is difficult to pin down a single specific definition of “entrepreneur” suitable for all contexts but in most contemporary research, the key elements of earlier definitions of entrepreneurship in this context have remained. Entrepreneurship has consistently been conceptualised as a self-interested concern for profit from competitive market activities, being the sale of goods and services, pursued through innovation or recombining resources and taking market opportunities, often done in new enterprises, and through which entrepreneurs change the status quo. For example, Davidsson (2005, 16) proposes that entrepreneurship “drives the market process towards more effective and/or efficient use of resources”. This can be our working definition of entrepreneurship for tax policy purposes.

### **3.4. Case studies**

#### *3.4.1 Triangl Bikinis*

Consider the case of Triangl (Case Study 1 in the **Appendix**). Triangl is the wildly successful bikini business of former AFL footballer Craig Ellis and Erin Deering, started in 2012. There is no doubt the owners – who are Australian – are entrepreneurs. They have created a start-up, fast growing business from nothing in 3 years, using new materials for a somewhat tried and true product; applying novel selling and marketing techniques; finding a gap in the market and fully selling online while keeping the Australian brand, which seems to help in selling a bikini (they have a .com.au website and use their Australian branding to

help sell, many sites saying they are a “new Australian swimwear line”). Triangl bikinis appear to be made in Taiwan and China presumably through third party contracting (though it’s hard to know). Triangl pays for warehouse space in Australia, no doubt quite a small space, as bikinis are compact, for their online delivery and return service (and presumably they also do this in other countries). But all marketing, sales, etc are done online. It’s not clear where design is done, they “plan” a design office in NYC but perhaps this is just hype. Their “supply-chain” office with about 10 staff is in Hong Kong (a low tax country). Jobs are created - in China and Hong Kong. Craig and Erin live in Monaco (a tax haven) and their “management decision-making” company is in the Channel Islands (a tax haven). Nothing is produced, or designed, in Australia and we are only a small part of the global market.

What, if anything, would need to change about Australia’ tax system to keep Craig and Erin, the Triangl entrepreneurs, “at home”? *Could* we change anything that would make a difference? It seems we would need to cut both corporate and personal tax rates dramatically and even that would most likely not be enough. Manufacturing, design, global marketing and all logistics are done no doubt at much lower wages in SE Asia. More fundamentally, *do we care?* Triangl, though a great Aussie story, seems not to be the kind of entrepreneur we want to support with specific concessions. In any event, Australia cannot compete: there is no realistic Australian tax or regulatory policy to support entrepreneurship that would be relevant for Craig and Erin.

### 3.4.2 Emma’s 3DPrintSmart business

Malcolm Turnbull is not, really, looking for a bikini-led recovery (in either the Australian economy or tax revenues). What is he aimed at? In the Innovation Statement, the example of Emma developing a 3-D printer for agricultural products is presented (see Appendix). Emma establishes a company, 3DPrintSmart Pty Ltd, in Australia. Given what we just said about Triangl in Case Study 1, the first question has to be: Why did she not set up her company in Hong Kong from the start? Well, it seems that she does not have a good or service ready to take straight to market at relatively low cost, even in an experimental mode. She needs support for research and development and to develop this product. Also, its more costly than making and trialling a few bikinis.

We know that Emma needs an Australian company in order to access the R&D tax offset – that is a good reason for her to stay here in Australia. Google has operated on the

same logic. Also, it seems Emma is going to be doing most of the development work herself and she (currently) lives here. It is not clear, but she presumably she uses up the R&D refundable tax offset to pay herself enough to live on (you can't eat stock options) if she does not have other income, so the personal income tax would apply to her as an individual. There is no cashflow yet in 3DPrintSmart, so deductions are accumulating as tax losses inside the company.

After she does initial R&D, Emma needs capital to develop for market. It seems she cannot attract bank loan capital and she has no cashflow to service a loan. The proposed Angel investor, Mr A, makes a \$1 million equity investment (we assume) and he gets the \$200,000 investor tax credit. This is extremely tax-effective for him. At a top marginal tax rate of 49%, Mr A can shelter \$408,164 of other income from tax. Presumably he takes up some shares, we don't know how much – but if its more than 50%, we are going to be thinking about carry-forward tax losses (later). It's also not clear in the brief information provided, but perhaps this tax credit will reduce Mr A's cost base in his 3D shares; however, he also has a capital gains tax exemption so perhaps that is irrelevant.

Emma then needs an additional injection of \$10m capital to “produce and market her 3D printing service to farmers) and this is provided through an ESVCLP, which accesses a further 10% upfront credit for its investors, and benefits from a capital gains tax concession down the track. Its vague in the facts as to whether Emma herself has the printer(s) and provides the parts to farmers, or whether she is selling them the printer. Its also not clear who builds these printers. Surely, by now, Emma has found a manufacturer in Indonesia, China or Thailand who can build 3D printers for her? Why is she not out-sourcing this? Does she have a factory in Australia which is employing people? If farmers call up to ask for a part – is she using a Bangalore call centre to manage the calls?

There is a suggestion down the track that 3DPrintSmart will benefit from the modified “predominantly similar business” test but again, it is not clear how or why. Presumably, the company becomes profitable at some point. The SBT is not needed unless there is a change of ownership. Does Mr A control more than 50% of the business, or will Emma do an IPO or sell out privately down the track? If the business continues to do 3D printing of agricultural parts, then the modified SBT is not going to be necessary for carryforward loss deductions. However, if it changes direction slightly, perhaps this modified loss test will be helpful, as long as it continues to pay Australian company tax.

All of these questions indicate that we do not know enough about Emma's business, and this example is really extremely vague. However, this brief discussion suggests that the only thing that may keep Emma here in Australia is the fact that she does not yet have a marketable product; that there are features about her product that are tied to Australia, e.g. her (initial) market is here in Australia and perhaps, parts are unique and linked to specific features of Australia's agricultural production chain; and that here, she is receiving grants, capital and tax subsidies for the start-up.

### 3.4.3 *CSL's biotech factory in Switzerland*

In 2014, there was news about major Australia multinational CSL's new biotech manufacturing plant which will employ 500 people and which it will locate in Switzerland: apparently for tax, market and employee reasons.<sup>7</sup> CSL does a lot of production in Australia and is no doubt one of the great science/tech success stories. However, it now operates globally. CSL was upfront about the tax issues and put in a submission to the Re:Think tax discussion paper calling for a 10% "advanced manufacturing" tax rate, or a patent box in Australia (CSL 2015). Of course, CSL would want this to be available to large businesses and multinationals – not just SMEs.

I suggest that all three of these examples are entrepreneurs as defined by Schumpeter and Kirzner, who may be successful in the market and who are driving market change and potentially global economic growth. But what is the value of their entrepreneurship to Australia and what is the relevance of tax policy to their activities?

## **4. What do we want from entrepreneurship?**

The discussion above suggests that as a fundamental principle, policy makers should aim to support entrepreneurship that leads to economic development that can produce social surplus. They should not be interested in entrepreneurship that merely redistributes resources in the market (a zero-sum game) or is, even, negative or destructive. However, policy makers want more from entrepreneurship than this. They tend to go further than just

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<sup>7</sup> Sally Gardner, "Why CSL chose High Cost Switzerland over High Cost Australia" (August 14, 2015) Australian Financial Review <http://www.afr.com/business/manufacturing/why-csl-chose-high-cost-switzerland-over-high-cost-australia-20140817-j8hlx>



arguing to support entrepreneurship as a vehicle of economic development or “creative destruction” of the market.

In particular, policymakers seek from entrepreneurship: new jobs and technological innovation. This is what has led to much of the focus on entrepreneurship in tax policy, especially for SMEs. For example, the OECD says (2015a, 13):

In most countries, small and medium-sized enterprises (SMEs) represent more than 95% of all firms. SMEs account for a large proportion of total employment and contribute significantly to national and global economic growth. They are also strongly heterogeneous: across and within industries and sectors; in their innovation behaviours; and in their profitability and growth potential. Importantly, SMEs also generate a significant share of all taxable business income in most economies. SMEs are important for their contribution to employment, economic growth, innovation and the diversity and competition that they can bring to markets. As a large and important part of all national economies, SMEs often face challenges to their viability and growth, some of which are created by market failures, capital market imperfections and compliance costs.

#### **4.1. Jobs**

It is commonly suggested that entrepreneurs create jobs and hence that tax incentives may be justified on this basis. The European Commission in its Entrepreneurship 2020 Action Plan has embraced this perspective, stating in its recent report that “new and young enterprises represent a key ingredient in creating a job-rich recovery in Europe” (EC 2012: 27). It cites US data suggesting that jobs in new firms represents the most important source of new employment and that, in Europe, “new companies, especially SMEs, represent the most important source of new employment: they create more than 4 million new jobs every year.” (EC 2012, 4<sup>8</sup>). This suggests that new – and growing – businesses should be the object of entrepreneurship policy and, specifically, entrepreneurship tax policy.

However, we need to be clear what is meant by “new jobs”. As can be seen in the Triangl case study, entrepreneurs do not always create the jobs that Australian policy makers care about: Australian jobs. Should we define “true” entrepreneurship for our policy purposes to include a mere shift from wage earning to self-employment, or work as an

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<sup>8</sup> citing Kauffman Foundation "Business Dynamics Statistics Briefing: Jobs created from business start-ups in the United States" [http://www.kauffman.org/uploadedFiles/BDS\\_Jobs\\_Created\\_011209b.pdf](http://www.kauffman.org/uploadedFiles/BDS_Jobs_Created_011209b.pdf). And calculation based on Eurostat data (2009)

independent contractor? It may be increasingly common that individuals today earn both wage income from a job and self-employment, small business or contractor income. Is this an increase in either jobs or entrepreneurship? Or is this a zero-sum game?

The majority of small and new businesses are sole proprietorships. Moreover, evidence from the US (consistent with Australia) is that most small businesses stay small – they do not grow as they mature (Hurst and Pugsley 2011, discussed in Gale and Brown 2013, 877). In Australia, Hendrekson (2015, 7) concludes that “over the period 2006 to 2011 we estimate that 1.04 million full time equivalent jobs were added to the economy. Young SMEs are responsible for the majority of this net growth having added 1.12 million jobs in that period.” Most new jobs are provided by smaller young firms. In the US, there is evidence that most new jobs are created by young and innovative firms, rather than small firms – “it is not “small-ness” that is driving net job creation, it is relative “new-ness”” (Gale and Brown 2013). New or young firms are also responsible for lots of job destruction, as many of them go under, but if they survive, they tend to grow faster.

#### **4.2. Innovation**

Second, we want our entrepreneurs to be doing something innovative with new knowledge and technology that could create positive spillovers for the rest of us. The assumption here is that the return to innovation cannot be fully captured under intellectual property and market settings (this may also be a reason to subsidise entry into innovative businesses). We are looking for a new business, but more specifically we want a business doing new things or doing things in new ways. Just as the proxy of “small business” is not good enough to identify the “true” entrepreneur, the characteristic of being a “new” business is also not good enough. Merely identifying an arbitrage opportunity in the market may not be enough to satisfy the policy goal of innovative combinations and/or bringing new knowledge to market.

In the Triangl example, it may be that the positive spillovers in Australia are first, nice bikinis at a good price and second, copies of the nice bikinis by other suppliers at an even better price (but perhaps breaching intellectual property law). It seems unlikely that those other suppliers are manufacturing in Australia. Again, however, Craig and Erin went off and did their own thing in the global market without any Australian tax subsidies. Apart from subsidising the AFL and our swimming sunshine global “brand”, did Australia contribute at

all to their success? What about 3DPrintSmart? The point of this example is to illustrate an innovative technology to bring goods to market.

For over a decade, the OECD has been evaluating innovation, and what kinds of policies might support innovation which has a positive effect on the economy and people's lives. In one of its latest publications on the subject, the OECD defined innovation as 'the implementation of a new or significantly improved product (good or service) or process, a new marketing method, or a new organisational method in business practices, workplace organisation or external relations' (OECD 2015, 16). Innovation can include a wide range of activities besides research & development (R&D), such as 'organisational changes, training, testing, marketing and design'.

[FIGURE 1 NEAR HERE]

According to the OECD, the particular contribution of innovation to economic growth can be thought of as part of a production function (figure 1). In this framework, growth in economic output is a product of tangible and intangible labour and capital from increases in multifactor productivity (MFP). MFP is the part of output growth that cannot be explained by increased inputs of capital and/or labour. Innovation can contribute to growth through technological progress, by investment in new or more advanced physical capital, like machinery or computers, or through investment in intangible capital, such as software, firm-specific skills or R&D. Lastly, innovation can contribute to growth by increasing MFP growth, through the more efficient use of labour and capital. This can be through technological innovation, but also organisational or social innovations.

Prime Minister Turnbull has noted that innovation is a dynamic activity. The OECD suggests there may be three stages of dynamic innovation. First, firms invest in innovation to develop new ideas or adapt new technologies. In the second stage, firms implement and commercialise these ideas. In the third phase, firms reap the benefits from innovation as their market shares change and their profits increase. The reallocation of resources from declining to growing firms is what increases MFP growth, as labour and capital are being used more efficiently. MFP growth is important for growth in countries which have few options for productive investment in tangible capital, and is critical for long-term, sustained productivity-led growth (OECD 2015, 19). It is therefore argued by the OECD that Governments should support policies which improve MFP growth, of which innovation is a part.

If innovation involves dynamic activity, which leads to the creation of new firms and activities, and the decline of others, there will be winners and losers (OECD 2015, 24–5). For example, some firms will close, and some workers will lose jobs, in industries or areas where innovation has brought about change. This suggests there is a negative side to innovation, at least in the interim, as resources are reallocated. Governments need to be aware of this—a point which was lacking from Turnbull's description—and ensure they have complementary policies to support workers through structural change brought about by innovation, such as effective skills, labour market and social policies. Managing such risks should also extend to having contingency plans in areas such as health and safety, the digital economy and financial markets. Managing the risks of innovation may also be important for alleviating income inequality, as well as other determinants of health and well-being for those affected.

These two OECD innovation frameworks provide a reference point for evaluating Australia's approach to innovation. The contribution which innovation is said to play in economic growth, and in particular MFP growth, can help to understand why the Government has supported innovation, and what its goals are. The rationale for innovation policies can help to understand why the Government has proposed certain policies—either to boost returns from investments, or prevent under-investment. As innovation is a dynamic area, there are risks associated with it. Governments should pay attention to the kind, and sequence, of policies so that innovation is likely to have, on average, a positive effect on economic and social outcomes.

[FIGURE 2 HERE]

### **4.3. What are the impediments to entrepreneurship?**

An argument for using tax incentives (or other regulatory interventions) to support entrepreneurship may be premised on a view that there is a market failure, or misallocation of resources, and moreover that this is bad for national wellbeing (or economic growth). The literature suggests that there are at least three possible misallocations.<sup>9</sup>

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<sup>9</sup> See Roger Gordon, UCLA/NYU Symposium comments, <https://uclalaw.hosted.panopto.com/Panopto/Pages/Viewer.aspx?id=425007c3-2834-43b0-bfc3-0e07547d75bb>

#### *4.3.1 Not enough innovation*

There may be considered to be too little innovation for national wellbeing, and this may be either because entrepreneurs cannot capture or benefit sufficiently from the return or surplus to innovation, or because there is inadequate market information about the value of innovation, so there is underinvestment. We value entrepreneurship because of the positive innovation spillovers, but if those spillovers are too great and the entrepreneurs do not manage to capture the economic benefits of their own innovation, we may not have those spillovers at all. One way in which entrepreneurs may not capture enough of the benefits could be because we tax them too much – either on their ongoing, regular returns (profits) or on their gains on exit (capital gains).

Consequently, governments might choose to pursue innovation policies for traditional market failure of information asymmetry reasons, as supported by neo-classical economics. However, the OECD suggests there are other reasons to support innovation. Figure 2 summarises a diagnostic framework for identifying the key constraints to innovation, according to what limits the returns to investment in innovation. The OECD has divided these constraints into two categories (OECD 2015, 25–6). The first refers to low economic returns, which includes factors that can create systemic barriers to innovation. These include barriers to competition, lack of co-operation within an innovation system, prevailing norms and habits, as well as technology lock-in. They can also be capacity constraints, or ‘low social returns’, associated with a lack of skills or infrastructure, or inadequate institutions.

Market and government failures may prevent firms, or other actors, from capturing the full value of their investments in innovation—that is, there is a low appropriability of returns. Examples include the externalities associated with investment in R&D, where firms cannot capture all the return on investments, because of knowledge spillover, or the negative externalities associated with environmental damages, which do not have a clear market price. This makes it difficult for firms to appropriate any returns from innovation.

#### *4.3.2 Lack of capital*

Second, it is assumed that entrepreneurs face credit constraints and lack capital. This may be a cashflow problem – inadequate revenue flows to pay employees or the daily expenses of a growing business – or it may be a capital investment problem – inadequate startup or

growth capital to carry out a major technological, market or infrastructure investment needed to take an innovative good or service “to the next level” or to market. Credit constraints and lack of capital may arise because of financial market failures and asymmetries, such that entrepreneurs seeking to innovate and grow cannot successfully communicate their own knowledge and likely future super-profits to the financial markets or investors. Consequently, there is inadequate capital investment in the entrepreneur (whether in the form of debt or equity) to support the entrepreneur to grow. Again, a possible reason for this could be the design of tax rules applying to debt or equity investment, or it may be argued that tax incentives are needed to encourage investors to put capital into the businesses of “true” entrepreneurs.

On the assumption that capital constraint is a key issue for entrepreneurs, many tax incentives are aimed at increasing venture capital investment, assuming “market failure” in provision of capital for innovative enterprise. However, this does not mean that the appropriate public policy for venture capital is obvious, or that government intervention will be successful. A wide range of forms of intervention in support of venture capital has been applied in various countries (e.g Sandler 2004). Diverse forms of government intervention have also been, or are currently, adopted to some extent by the Australian government.<sup>10</sup> European policy-makers have since the 1990s actively sought to create European venture capital markets and to increase US investment in European ventures and there has been increasing interest in encouraging venture capital in the Asia Pacific region (e.g. EC 2000).

#### 4.3.3 Risk

Third, and related to the second point, “true” entrepreneurship is highly risky and generates, early on, significant losses and has a high risk of failure. The risk relates to the Knightian “unknown probabilities” referred to above. Entrepreneurs cannot diversify their risk and cannot spread it among sufficient numbers of investors. This may be a result of financial market failure (inability to communicate about risk and return) or it may be a result of regulatory or tax impediments, for example, restrictions on use of tax losses upfront.

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<sup>10</sup> Current Australian government grant and investment programs are explained at [www.ausindustry.gov.au](http://www.ausindustry.gov.au).

#### 4.4. Proxies for entrepreneurship in tax policy

The challenge for tax policymakers, as in other areas of policy, remains: how to identify such “true” or “good” entrepreneurs doing things that we want to support? Ultimately, we need to identify indicators or proxies for identifying the “true” entrepreneurs. This is, in any event, what already happens, although these proxies are not always well elaborated or explained. As Donald Bruce<sup>11</sup> observes, tax policy makers (in spite of the fact that we probably cannot measure accurately true entrepreneurship) have in reality chosen to use the tax law in multiple ways and thereby have assumed that proxies can work.

Various proxies for entrepreneurship have been used in tax policy, in particular (1) small business; (2) new business; (3) tech, digital or science-driven business or existence of intellectual property (as a measure of innovation). Less obvious proxies are high risk business (e.g. measured by the extent of losses); and growth businesses (e.g. measured by growth over time).

As a result of the focus on the individual's entrepreneurial characteristics and the emphasis, since Schumpeter, of start-up enterprises and new opportunities, it is often assumed that small and new firms are where entrepreneurship occurs (Hölzl 2010, 187). It is further assumed that the activities of small and new firms drive economic growth. A constant flow of new entrepreneurs starting-up ventures is assumed to be good for the economy (Freeman 2014, 11). Activity is associated with dynamism and growth. The federal Government's small business package is a prime example of this thinking displayed in public policy.

Scholars of entrepreneurship investigated the activity in small and large, or mature, firms although Schumpeter, in his later work, proposed entrepreneurship could, and should, occur in larger, more mature firms. Consistent with his views that change in capitalist markets drives economic growth, Schumpeter (1954) argued that “large-scale establishments” were essential to the long-term expansion of output and economic progress.

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<sup>11</sup> NYU/UCLA Colloquium <https://uclalaw.hosted.panopto.com/Panopto/Pages/Viewer.aspx?id=425007c3-2834-43b0-bfc3-0e07547d75bb>

The proxy of “small business” is now generally discredited as a useful indicator of a “true” entrepreneur. Yet small businesses, or at least, a much broader category of SMEs, remain a focus of much entrepreneurship tax policy. What about the proxy of a start-up or “new” business? Scholars (e.g. Low and MacMillan 1988, 141; Newbert and Hill (2014, 247–9)) have recognised the creation of new enterprises, loosely defined, as a key feature of entrepreneurship. Nonetheless, the proxy of a “new business” is not always a good indicator for policy either (is a start-up beautician, or restaurant an entrepreneur warranting tax incentives, in the sense intended here?). Specific proxies, such as a “new company” may be clear but are likely even less useful, as they may just indicate a change in organisational form.

#### **4.5. Planning, behaviour and tax arbitrage**

Tax policies for entrepreneurship aim to address all of these issues: inadequate innovation, inadequate capital and excessive risk, in various different ways. As we do not really understand which is the most important issue, usually a range of policies seeks to address all of these problems – a “scattergun” approach – that seeks to generate responses among entrepreneurs and investors – to change their behaviour.

However, distinguishing between “productive” entrepreneurship and “gaming” or tax arbitrage that is costly or neutral in its impact on markets or society may be very difficult. It is worth a short discussion of tax planning and arbitrage. In Scholes, Wolfson et al (2015, 22), the authors (who are the leading proponents of tax planning as a part of business strategy) explain that effective tax planning aims to maximise after-tax returns, taking account of the costs of contracting including tax minimisation. In particular, in a world where in the normal course, taxes are levied on business (and other) transactions:

“[T]he taxing authority is an uninvited party to all contracts. The taxing authority brings to each of its “forced” ventures with taxpayers a set of contractual terms (tax rules). ... although the taxing authority claims an interest in taxpayer profits, it exercises no voting rights.”

Tax incentives that discriminate between different economic activities have potential to change taxpayer behaviour because of taxpayer response to them. From a policy perspective, Scholes et al (2015, 24) suggest:

“Success is achieved when the tax rules subsidize activities that benefit society as a whole more than they benefit the individuals engaging directly in the activities. ... For better or for worse, tax-favored treatment is granted to a variety of activities by taxing



authorities around the world. Common examples include the favourable treatment accorded charitable organizations and educational institutions, energy related investments, research and development activities, agricultural production, investments in productive equipment, foreign export activities, retirement-oriented savings vehicles, and entrepreneurial risk-taking activities.

... [A]ny tax system designed to achieve a variety of social goals inevitably provides considerable private incentives to engage in tax planning. Any tax system that seeks both to redistribute wealth as well as to subsidize certain economic activities gives rise to explicit marginal tax rates that may vary widely from one contracting party to the next, for a given contracting party over time, and for a given contracting party over different economic activities. Most taxpayers around the world pay no more tax than they believe they must and they spend nontrivial resources to arrange their affairs to keep the tax bite as painless as possible. It is precisely this behavior that provides tax policy with so much potential as a means of achieving a variety of social goals.”

#### 4.5.1 *Effect of tax rates*

Some research suggests that tax rates have different effects at different stages and that they will have a different effect based on the risk profile of the taxpayer. One suggestion is that for a risk-averse taxpayer, a progressive tax rate can generate more entrepreneurial activity “since progressive taxes provide a form of insurance by imposing lower average tax rates when income is low”, increasing as income increases (Gale and Brown 2013, 883; Cullen and Gordon 2007). However, risk- neutral or risk oriented taxpayers will be deterred from higher risk activities by progressive taxation, unless losses are fully offset (ibid.).

These analyses take account of taxpayer profile but not of the ability to trade. A key to tax planning behaviour – and critical important for tax policy makers to remember – is the ability for taxpayers to contract so as to trade or share tax savings. The classic example is low tax bracket or exempt taxpayers, trading with high tax bracket taxpayers. A low tax bracket taxpayer may sell their tax benefits to high tax bracket taxpayers, producing a tax *arbitrage* in which both parties are better off at the expense of the revenue. The existence of these different kinds of taxpayer – *tax clientele* – will, if sufficiently widespread, affect the market price of certain investments or deals, thereby changing the before-tax rate of return as certain investments become attractive (after-tax) for some kinds of taxpayer and not for others.

It is precisely the planning behaviour of taxpayers which is required, and relevant, for targeted tax incentives of any sort to work. Yet, it is precisely the tax planning behaviour of individuals which contains within it the risk that the tax incentive will over-reach and will be

more wasteful than productive, generating deadweight costs. This should, at the least, generate scepticism in policymakers as to whether tax measures will succeed in achieving goals. However, as Scholes et al observe (ibid.):

“Although the deadweight costs associated with time spent in tax planning may seem socially wasteful, the relevant question is how much waste would exist using alternative means to achieve the same social goals.”

Tax planning occurs not only around specific tax incentives but wherever there is a boundary or margin in the tax law either side of which has a different tax rate. Research into tax elasticities shows that not all taxpayers plan all the time, but that where tax planning is possible or easy, then taxpayers do plan, lowering their taxes without necessarily doing anything different or more productive in the market.

For example, moving from a progressive personal income tax rate structure into a lower taxed company tax structure, for personal services income, will be done if it is easy (e.g. Crawford and Freedman, 2010 on the zero small company tax rate in the UK, applicable between 2002 to 2004). As is well known in the tax profession, other margins include debt and equity financing; diverse entity structures; leasing compared to ownership of assets; receiving returns as wages, dividends, other income or capital gain. The tax law – and policy goals – can appear schizophrenic between “promoting enterprise” and “tax avoidance” – producing “a recipe for complexity and confusion” (Mirrlees 2011, Chapter 19). It is suggested in some of the literature that the differential between the progressive tax rate on wages and the lower (often flat) rate on companies is an incentive to entrepreneurship. However, distinguishing a “productive” entrepreneurship response from a likely much more widespread tax planning response (for example, personal services companies) seems impossible.

#### *4.5.2 Compliance and regulatory cost*

The literature on small businesses pays significant attention to compliance and regulatory costs, however, strangely this is not the main focus of research about tax policy for entrepreneurs. The evidence is clear that small and new businesses face higher costs relative to their size and this is acknowledged in the Re:Think paper (e.g. Evans, Tran-Nam 2014). Yet most tax incentives aimed at entrepreneurs do not aim to reduce compliance and regulatory cost, but may, indeed, have the opposite effect.

## **5. Design of Australian tax incentives for entrepreneurs**

This section aims to discuss what proxies are relied on for entrepreneurship in each measure, what entrepreneurship policy goal is sought to be achieved and how this fits with tax policy in general.

### **5.1. Reducing the cost of wages: Employee shares and options**

In 2014, the Government amended the tax law relating to employee shares and options to make it easier for businesses to use employee ownership schemes (ESS) to attract funds, in particular for start-ups (Australian Government 2014, 76–8). The Government reversed changes made by the Labor government in 2009, in which employee shares were taxed when they were issued, rather than allowing tax deferral or taxation when they are converted to shares.

Entrepreneurial start-ups, along with other firms, will be able to offer ESS shares to their employees, at a discount, and have that discount exempt from up-front taxation, so long as employees hold their shares for at least 3 years. Firms eligible for this concession should have an aggregate turnover of less than \$50 million, be unlisted and have been incorporated for less than 10 years. This measure, and the ESS changes, came into effect in July 2015 (Andrews 2015b).

The Government proposed the Australian Taxation Office will work with industry to develop a standardised process, and documentation, to streamline establishing and maintaining an ESS, so that this process is less of a burden to firms, especially start-ups. The Government also proposed to extend the maximum deferral of tax on stock options from 7 years to 15 years, and update ‘safe harbour’ valuation tables, to reflect current market prices for the value of options. A \$1,000 up-front tax concession for employees who earn less than \$180,000 per year is also retained, at a cost of \$200 million over four years.

### **5.2. A lower tax rate on entrepreneurial profits**

The 2015 Australian federal budget contained, among other initiatives, \$5.5 billion of expenditure on tax concessions for small businesses with annual turnover under \$2 million. The elements of the package included (Australian Government 2015a): a tax cut of 1.5 percentage points for small businesses, lowering the company tax rate to 28.5 per cent, and costing \$1.45 billion. So far, in general Australia’s tax reformers have not gone down

the path of lowering the tax rate on profits or on wages, except indirectly (through employee shares above, or to the extent that capital gains really reflect the return to work). However, the case studies of Triangl and CSL suggest that the tax rate on corporate profits, at least – and probably also on the owners and workers – may be important to entrepreneurial decisionmaking.

### **5.3. Lower tax rate on capital gains of owners or investors**

This is already achieved in our tax system by the discount capital gains tax rate. Indeed, it is the distinction between the top personal marginal rate on wage labour and the lower capital or corporate tax rate that delivers the incentive. This gap between the individual wage tax rate and the corporate tax rate has been argued in some of the literature to operate as a subsidy to entrepreneurship (e.g. Roger Gordon 1996).

#### *5.3.1 CGT discounts and exemptions*

The capital gains 50% discount halves the tax rate applicable to net capital gains, so top marginal rate taxpayers pay only 24.5% on capital gain. Superannuation funds and trusts also benefit from the CGT discount. The Government proposes in addition, a 10 year exemption on capital gains tax for angel investors, provided investments are held for three years.

#### *5.3.2 PDFs*

The Pooled Development Funds (PDF) regime (see Barkoczy et al (2001; 2003); O’Connell (2004), <sup>12</sup> was established in 1992. It continues to operate, but is closed to new registrations. A PDF was a company for tax purposes that operated as an intermediary collective investment “fund” that invested in shares of eligible investee companies.<sup>13</sup> A PDF could invest in newly issued ordinary shares of a company with total assets of less than \$50 million conducting activities other than retailing or property development. It could usually take up between 10% and 30% of share capital. PDF taxable income and gains from investments in qualifying SMEs was taxed at a 15% rate and other “unregulated

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<sup>12</sup>

<sup>13</sup> Division 10E of Part III of the Aus ITA 1936.

investment” taxable income and gains was taxed at a 25% rate. If a PDF made venture capital gains, Australian superannuation funds and similar investors in the PDF may receive those gains tax-free. Unfranked dividends are exempt for investors and where tax is paid, a PDF may frank up to the 30% company tax rate. A PDF is not able to flow through losses. PDFs must report annually to the Department of Industry. They require a financial services licence and there are a range of investment, loan and governance restrictions. Since 1992, “\$1 billion has been raised by PDFs and \$832 million of this capital has been invested into 760 Australian companies.” Although closed to new registrations since 2007, during 2012-13 there were 29 registered PDFs and these collectively raised \$12.3 million for new investments.<sup>14</sup>

### 5.3.3 VCLPs

Australia’s VCLP regime was introduced in 2002.<sup>15</sup> The PDF regime was viewed as too restrictive in respect of regulatory requirements and there seems to have been a perceived need for greater investment flexibility (e.g. six of the 15 deregistrations in 2004 were by companies “who were seeking to pursue investment activities not permitted under the PDF Act”).<sup>16</sup> PDFs were also not generally attractive to foreign venture capital investors because they did not have flow-through tax treatment and the investment restrictions to which they are subject, including limits on investment and a requirement to invest in new ordinary share issues, meant that they did not fit with the structure of US venture capital funds. In 1999, the Review of Business Taxation recommended a new tax incentive to target foreign venture capital (RBT 1999, Recommendation 19.1, 611, 614). The Review was “advised” (by, among others, submissions from AVCAL and Deloitte) of an “overwhelming consensus among venture capital experts and others involved in high technology start-up companies that Australia’s taxation treatment of capital gains penalises investment and management participation in such companies” (RBT 1999, 298). The Wills Strategic Review of Health

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<sup>14</sup> Department of Industry, <http://www.business.gov.au/grants-and-assistance/closed-programs/pdf/Pages/PDF-FactSheet.aspx>.

<sup>15</sup> Venture Capital Act 2002 (Cth), Taxation Laws Amendment (Venture Capital) Act 2002 (Cth). Minor amendments were also made by Taxation Laws Amendment (Measure No 3) Act 2004. See Stewart (2006); Rider et al (2005); Howe and Howell (2003).

<sup>16</sup> Ibid.

and Medical Research also recommended tax reforms to attract foreign capital (Wills 1998, Ch 4.2).

In 1999, the government enacted an exemption from tax for tax-exempt pension funds from Canada, France, Germany, Japan, the UK and the US that invest new equity in a qualifying “resident investment vehicle”. This exemption was overtaken by the VCLP regime and by the exemption of capital gains on Australian shares owned by non-resident investors enacted in 2006. The 1999 exemption, specifically aimed at US pension funds, did not succeed in enticing investment by them. This may have been because the 1999 exemption did not allow flow through taxation of US funds of funds, or take account of entities that combined tax-exempt and taxable investors, both issues which the VCLP reforms attempt to address.

Accompanying those reforms were changes to facilitate limited partnership structures. One goal of these venture capital concessions was to attract foreign investment. Second, the venture capital measures were among a range of measures being adopted in an attempt to “engineer” a domestic venture capital market (Gilson 2003), so as to promote “innovation-led growth” through commercialisation of intellectual property in new enterprises. The VCLP regime provides a capital gains tax exemption for certain listed foreign investment pension funds and investors, and for Australian taxable investors. It also allows flow through of capital losses to taxable investors.

On its introduction, the government estimated that the VCLP reform would cost \$21 million in 2003-2004, \$25 million in 2004-2005 and \$30 million in 2005-2006 in revenue foregone, but did not explain which aspects of the reform would generate these revenue costs.<sup>17</sup> The Tax Expenditure Budget 2004 described the investor exemption as a capital gains concession and estimates that it would cost \$20 million in 2003-04, and \$30 million in 2005-06 and subsequent years in revenue foregone (Treasury 2004).<sup>18</sup> One concession for VCLPs is the treatment of manager “carried interest” as capital gain, halving the personal income tax on managerial labour. The TES 2014 finds this tax expenditure is not

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<sup>17</sup> Venture Capital EM, p4.

<sup>18</sup> In contrast the PDF regime is estimated to cost only AUD 6 million in each year, Item B17, p78.

quantifiable (Item B48), as it did on introduction; it is not clear to what extent this concession benefits individual VC managers.

In 2005, there were nine VCLPs, formed as incorporated limited partnerships, registered or conditionally registered and with committed capital of AUD 1 billion. A decade later, there were 41 VCLPs registered at December 2015 and 14 conditionally registered VCLPs.

#### 5.3.4 Early Stage VCLPs

A modification to the VCLP regime was introduced a few years later. MORE TO COME.

There were 17 ESVCLPs registered at December 2015 and 12 conditionally registered ESVCLPs. The TES 2014 states that the CGT exemption for domestic and foreign investors in ESVCLPs is not quantifiable (Item B59). The ESVCLP measures are purportedly intended to encourage investment in *new and growing* enterprises which have difficulty accessing capital. The Explanatory Memorandum stated the aim was to provide “incentives for increased investment which will support patient equity capital investments in relatively high-risk start-up and expanding businesses that would otherwise have difficulty in attracting investment through normal commercial means.”<sup>19</sup> However, it was a problem from enactment that ESVCLPs would focus at a later stage of investment. At least three out of the 9 registered VCLPs on commencement stated that they were focusing on “expansion or later” capital and one fund has the explicit goal of “listed buyouts with an enterprise value in excess of \$50 million, generally the divisions of larger listed Australasian conglomerates, or the local subsidiaries of foreign companies.”<sup>20</sup> The early indications of investment goals of Australian VCLPs, suggested that the venture capital reforms are not likely to provide capital at the “seed” or “angel” stage, nor even to provide capital to many “start-up” enterprises, but would be likely to target businesses with existing products, or a different kind of spin-off company: one that is sold out of an existing corporate group.

The other policy goals of both VCLPs and ESVCLPs include commercialisation of home-grown, publicly funded research and development and generation of skilled

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<sup>19</sup> *Explanatory Memorandum to Taxation Laws Amendment (Venture Capital) Bill 2002 (Cth) and Venture Capital Bill 2002 (Cth) (Venture Capital EM)*, p 3.

<sup>20</sup> Information obtained from Ausindustry, 5 October 2004.

employment and intellectual property formation in Australia. The provisions that seem intended to accomplish these goals are the rules regulating the activities and location of eligible investee companies including their activities and location. An eligible investee company must be a resident at the time of investment. The additional 'location in Australia' requirements seem at first glance to require significant Australian operations. However, the requirement for location of personnel and activities in Australia only applies for the first 12 months of activity of the investee company. Operations may be moved offshore after that time, which would seem to encourage shifting of new high tech manufacturing and similar operations offshore. In any event, the location requirement may be waived.

The problem is one of balancing flexibility for investors, access to capital and domestic industry policy. The VCLP regime aims to facilitate an investment market in a world of global capital, but imposes regulatory, location and capital restrictions. Those requirements will require time and attention for compliance by the private sector and government, but it seems quite possible to plan around them. AVCAL argued that the Australian regime contains too many restrictions that frighten foreign investors away because they constrain diversity of investments (Australian Venture Capital Review).<sup>21</sup>

#### **5.4. Expensing or accelerated depreciation of business assets**

The small business Budget package also included immediate tax deductibility for assets which cost less than \$20,000, between 2015 and 2017, costing \$1.75 billion; and \$70 million allocated to measures to 'encourage start-ups and entrepreneurship'. These included: allowing entrepreneurs to immediately deduct professional expenses incurred at start-up; tax concessions for employee share schemes, to enable employers to raise capital from their staff; and making it cheaper for small companies to become public companies, so that they can raise equity funding. Treasurer Joe Hockey argued that these sorts of measures would help give Australian small businesses the opportunity to grow (Hockey 2015).

In general, these measures apply in the context of effective life depreciation for most plant and equipment with the exception of a number of statutorily identified items which

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<sup>21</sup> Rob O'Neill, "Ideas for the clever country", *The Age*, 28 Sep 2004.



have accelerated depreciation. Intangibles including patents, copyright and designs are depreciable on a straightline basis, but many business intangibles including brands, trademarks, and knowhow are not depreciable at all; they may be immediately expensed if produced by a business, or else may be capital in nature. The Innovation Statement proposal to allow self-assessment of intangible assets for depreciation will lead to faster write-off of those intangible assets. This is hardly a patent box, but it is a nod towards the value and potentially short life of “new” inventions including patents. These measures lower upfront cost but are primarily useful where the entrepreneur has a flow of taxable income; otherwise, they just contribute to accumulating carryforward tax losses.

### **5.5. Losses and risk**

Australia’s income tax allows unlimited carryforward of tax losses for individuals and for companies subject to restrictions on continuity of ownership. If the business is sold, a strict “same business test” is applied and if failed, the losses are not available. Similarly, capital losses are quarantined to capital gains. This asymmetric tax treatment of losses is well known and perceived as a disincentive to entrepreneurship; however, the difficulty of preventing tax planning as regards unlimited use of tax losses or upfront access to tax credits, has meant that no country removes these limitations on losses fully.

In suggesting tax reforms today, Roger Gordon (NYU) seems to come down in favour of allowing tax savings on losses in startup firms, which he suggests are well targeted to entrepreneurial firms and would lead to gains from better risk allocation and relaxed credit constraints (Gordon 2015). This logic is behind the ability to flow through losses in VCLPs and ESVCLPs; the proposed relaxation of the same business test for company losses; and Australia’s recently enacted upfront credit for exploration expenditure.

MORE TO COME

## **6. The bigger picture: Benchmarks and tax policy goals**

To what extent can and should we pursue targeted tax policies for entrepreneurship and to what extent does this specific policy issue collapse into the broader question of the overall business tax system? The second quote at the beginning of this paper is from Billy Hughes (Attorney General at the time) in his speech accompanying the introduction of the first Australian federal income tax in 1915. Hughes was concerned with productivity then, just as

the OECD is today. Specifically, Hughes was concerned that the new income tax while needed for revenue and fairness, should “do nothing to discourage enterprise”.

The company tax rate on retained earnings in 1915 was about 7.5%, while distributed income from property, over a threshold of L156 annually, was taxed on a progressive rate structure up to a high rate of 60%. To the extent it was articulated (which was minimal), the policy goal was to encourage reinvestment of business profits in “enterprise”, and a rudimentary undistributed profits tax was already needed in 1915 (and was later expanded), to address the obvious tax planning advantage of retaining income taxed at a low rate in a controlled company. The “classical” corporate-shareholder double tax system was introduced in the 1930s to collect more revenue, and ultimately wound back in the 1980s with the introduction of dividend imputation. The company tax rate increased significantly over the 20<sup>th</sup> century – matching the personal top marginal rate of 49% when imputation was introduced – before being cut to 30% in 1999.

Australia’s company tax rate is 30% for most companies. Dividend imputation should mean that domestic shareholder investors are indifferent to the company tax rate where they will receive franked dividends; however, the start up and early stage entrepreneur is different from the profitable small or large business, as it does not have a steady stream of taxable profits. The entrepreneur may not pay much tax in early years (because of expenses and losses) even if it does generate taxable income; however, once tax is payable, a growing business that seeks to reinvest will pay 30% company tax which will be indirectly borne by the owners and investors. The anecdotal evidence of Triangl and CSL in the case studies above indicates that even Australian-originating businesses, small or large, that can gain access to a global footprint, will exit at least in part in response to taxes. It remains to be seen whether a business like Emma’s 3DSmartPrint would be any different once it gets into production.

As is illustrated by the case studies discussed above, economic globalization adds a further challenge for tax policy makers in identifying those entrepreneurs who we might want to support with tax policy. The global mobility of entrepreneurs and their ability to take advantage of different country tax systems and tax rates presents a major challenge to the relevance, or effectiveness, of any domestic tax policy for entrepreneurs that we might consider. Entrepreneurs are already helping themselves in a global world, taking advantage of low wages and regulation, global markets, low tax rates and tax incentives wherever they

can. Unless we are prepared to remove taxes altogether from entrepreneurial activity (and even that may not be enough), what does this mean for tax policy?

## **6.1. Benchmarks for tax policy**

Underlying much of the debate about tax incentives for entrepreneurship are assumptions about the correct benchmark for tax policy more generally. In general, discussion about tax policy and entrepreneurship focuses on the income tax. This makes sense: it is our only tax that applies to the return to capital investment or to profit, although it should be remembered that other taxes, for example wage taxes on workers and wealth taxes, may also be relevant to entrepreneurs.

### *6.1.1 Income tax*

A comprehensive income tax benchmark aims to tax net economic gain – consumption and accrued wealth – regardless of source or cause. Capital investment is depreciated over time as its value diminishes. All gain is included regardless of whether it is realised. In an ideal system, all losses are fully deductible (or indeed, there may be full loss offset required through trading or refund/credit of losses). The cost of financing with debt to generate economic return is generally deductible, but equity investment is capital and non-deductible. The comprehensive income tax should, of course, tax all returns to labour.

$$Y = C + \Delta W$$

In a comprehensive income tax, the Revenue shares directly in the gains from entrepreneurship – at whatever applicable rate – and also shares in the losses. In reality, the income tax does not meet the comprehensive income benchmark in many ways. Indeed, as explained in Ingles (2015), capital is already substantially under-taxed in our current tax system.

### *6.1.2 Expenditure (consumption) tax*

An expenditure tax benchmark does not tax the return to saving or investment, but only consumption (or labour returns). It also allows full expensing of capital investment. Net gain is not taxable, but neither are losses deductible. The cost of financing is not deductible if debt, but equity investment is deductible. The comprehensive expenditure tax should, of course, tax all returns to labour - unless they are deducted out of the tax base by being

invested. An expenditure tax is in this sense equivalent to a wage tax and if all wage income is consumed, both are equivalent to an income tax.

### *6.1.3 Economic rent taxation*

Another model of taxation aims to tax economic rents while exempting the normal rate of return to investment. As entrepreneurs aim to achieve economic rents or derive surplus profits in the market, a tax that captures part of that economic rent may, perhaps, operate as a disincentive to entrepreneurship. Notably, however, this suggestion runs counter to most economic theory about rents which suggests that on the margin, taxes on (immobile) rents may be as high as 100 % without deterring the activity which at least gains the normal rate of return. On that view, the business tax system should aim to exempt the normal return and may tax economic rents as high as needed for revenue or other social policy goals.

### *6.1.4 Business cashflow tax*

MORE TO COME

One researcher has concluded that none of these tax systems is neutral as regards entrepreneurial startups (REF).

## **6.2. Design of tax incentives**

Tax incentives or concessions for entrepreneurship may take various forms, but they tend to be directed to achieving one of the following goals:

1. Reducing tax on economic gain derived from successful entrepreneurial investment either by reducing tax on gain from sale, float or similar, or by reducing the tax on regular profit returned from certain kinds of businesses;
2. Reducing the cost of capital investment of a specified or general kind, through investment allowances or accelerated depreciation, or immediate expensing of investment;
3. Reducing the cost of equity finance, by allowing a credit or deduction for equity investment or capital contributions.
4. Spreading the risk of loss, by allowing upfront use of tax losses against other income, refundability or credits for losses, or trading of losses to taxable parties;

Of these four types of tax incentive, the first three shift the tax system for entrepreneurs towards an expenditure tax benchmark from an income tax benchmark. Potentially it moves business or corporate taxation towards a consumption or cash flow model. The fourth type of tax incentive does the opposite: it aims to produce a more perfect or ideal income tax by “properly” recognising tax losses in the income tax.

Another way to analyse tax incentives is by considering the stage of entrepreneurship or investment affected. The OECD historically described a simple typology of tax concessions to support venture capital (2004, 16). They may take the form of “front-end incentives”, whereby an upfront credit or income tax reduction is provided for investors in qualifying investments, or “back-end incentives”, whereby investors are taxed at a reduced tax rate on gains generated from qualifying investments. The Government’s proposed angel investor tax credit is a “front-end” incentive for the investor which makes capital available, or lowers the cost of capital, for the entrepreneur.

A problem identified with front-end tax incentives is that they are an up-front cost to the government, when the investment may not be successful, and they may lead to tax shelter activity. A front-end incentive may increase the number of venture capital investments but they may not be of high quality (or, in any event, successful). Most importantly, if we take behavioural tax planning responses to the system seriously, a front-end incentive is most likely to be gamed by the system, precisely because of its immediate availability. If the angel investor tax credit can be harnessed through funds or intermediaries and marketed to upper income taxpayers – your dentists, lawyers and doctors – then it will be just like the mass marketed forestry, agri-business, film and other upfront deduction or loss schemes, in attracting significant take-up, and reducing the tax of investing taxpayers substantially, while not necessarily generating productive investment or results. The design and administration of such a tax scheme is fraught with danger for policymakers and administrators. The history of Australia’s income tax is littered with upfront deduction schemes and the legislative and administrative measures required to shut them down.

In contrast, a back-end incentive rewards only “winners” who derive actual gains and so is less costly to government, but may motivate fewer investments overall. A generalized back-end incentive is simply a reduction in the capital gains tax rate for investors, which has been enacted in many countries, including Australia and the United States, and is essentially treated in most countries (in spite of critique) as part of the normal benchmark in

the income tax (New Zealand does not tax capital gains at all). There is a widely held view among economists and policy makers that reducing tax on gains from realisation of investments is an effective subsidy for entrepreneurship and may be better than a front-end incentive. Keuschnigg and Nielsen (YR) even proposed implementing a *tax* on investment at the front-end and an exemption on exit from the investment (see also Rosen 2005). A key reason is the risk-reward decision; higher (lower taxed) gain on successful investments is a reward for higher risk. This also leads to the view that lower tax on capital gains does spur entrepreneurship, supported by at least some empirical evidence that it affects the payout behavior of venture capital funds (e.g. Gordon, YR).

Nonetheless a back-end incentive on capital gain can also be gamed, as ongoing income or profit, in particular labour income, is converted into capital gain obtaining tax deferral and a lower rate. In fact, this like other incentives for entrepreneurship may ultimately lower the tax on the return to *labour* and not on *capital*, even those incentives which appear to be capital gains tax concessions. In some cases, this happens at the “front end”, by reducing the cost of labour to the entrepreneur (e.g. by allowing losses, or reducing the upfront cost of remuneration e.g. by employee share schemes). Fleischer suggests we should think harder about what makes up the capital return, in a world where taxpayers respond to taxes by changing behaviour along planning margins and using tax arbitrage. He<sup>22</sup> makes the argument that in the top 0.1% (United States), more than half of the amounts reported as capital gains for tax purposes really reflect labour income – what he terms “alpha”, the return to human capital. This is the result of various forms of tax planning combined with specific rules (such as carried interest of venture managers) Consequently, on this logic, a reduction in capital gains tax does not bring the tax base from comprehensive income closer to an expenditure base. Rather, it exempts the return to labour from taxation: not intended in any of the benchmark tax systems set out above.

More generally, when we take tax planning into account, many of the so-called capital tax concessions relating to entrepreneurs, their companies and their investors, may be reducing the tax rate on *labour* income for some kinds of individual taxpayer. Even the startup angel investment tax credit is going to shelter the labour or business income of the

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<sup>22</sup> NYU colloquium; X.

investor from tax – it is not reducing the tax on the ultimate return to investment in the entrepreneurial activity, or reducing the tax of the entrepreneur. As a matter of policy, however, is not expressed in this way because that would appear to undermine our progressive income tax rate structure applied to wages and your average employee.

It is simple enough to sort many explicit tax subsidies into front-end or back-end incentives. However, it is more difficult to analyse the effect of structural features of tax and entity law, such as the boundaries of capital gain or business income, the legal form of intermediary collective investment vehicles, or the impact of carryforward tax losses over time. As already noted, incentives may also exist – or, expressed differently, a benefit from tax planning for an entrepreneur may arise – in a range of other areas of the “normal” tax law. Indeed, a key issue in trying to understand either whether tax incentives for entrepreneurship can work, or in the use of tax data to understand entrepreneurship, is disentangling the tax avoidance or planning effects. Empirical evidence suggests that a great deal of the “tax effects” identified, eg to do with “self-employment” compared to wage employment, or incorporation compared to other small business forms, may be a tax planning response first and a genuine economic “entrepreneurship” response second. This may be driven by existing employers or large firms as much as by the individual or small business concerned. For example, increasingly large firms seek to out-source risk onto independent contracts. In response, there may be shifting from employee to “entrepreneur” status in response to taxes, but without there being “entrepreneurial” behaviour, or there may simply be a substitution of one legal form for a small business for another.

This is obviously the case in respect of legal entity choice, which could be a “front-end” choice of a startup firm, or arise during its lifecycle through conversion to a different entity, or on sale or exit, eg by floating on a stock exchange (e.g. see Crawford and Freedman 2010 on the effects of the zero rate for small companies in the UK; evidence from Europe of tax effects on incorporation). Tax incentives or returns to tax planning may also exist relating to the type of financing or capital investment available to an entrepreneur, depending on the tax treatment of debt and equity. Tax incentives or returns to planning may arise from “normal” depreciation and deductibility rules for intangibles including approaches to valuation of intangible assets in the tax law. And tax incentives or returns to planning may arise from different ways of treating wages or employees, including the personal tax rate, approaches to tax deductibility of wages and taxation of fringe benefits,

and the use of stock or stock options to remunerate employees attracting explicit or implicit tax concessions.

Does globalisation have the consequence that we should narrow our definition of the entrepreneur who we want, or need to subsidise? In our current tax concessions for PDFs and VCLPs, there is a range of restrictions on activities, location and employment. These add complexity and it is not clear if they will have a longer term effect. Do we need to put boundaries around the place, personnel, location of intellectual property and type of activity we want to support? How do we do that?

## **7. Conclusions... so far**

The Innovation Statement does not, really, do much in tax policy to support entrepreneurship. The overall estimated cost over the forward estimates including all of the grants and funds is only \$4 billion. This may lead to some relief among those aiming for broader tax system reform, or worried about its impact. However it also leads to questions about the goal of the measures included in the Statement. These seem to respond to ongoing sectoral interests and provides a short term tax kick to some kinds of investment, while invigorating tax planning and without necessarily having any broader effect.

A lesson from the entrepreneurship literature is that we don't really know, still, how to identify what entrepreneurship is, or what aspects of entrepreneurship we want to encourage, still less how to achieve this in practice. We have trouble identifying goals, and measuring either incentives or outcomes. In this environment it is not that surprising that policymakers will announce multiple and diverse measures. This multi-pronged (viewed positively) or scattergun (viewed less positively) approach is demonstrated in the recently announced package of measures in the Innovation Statement.

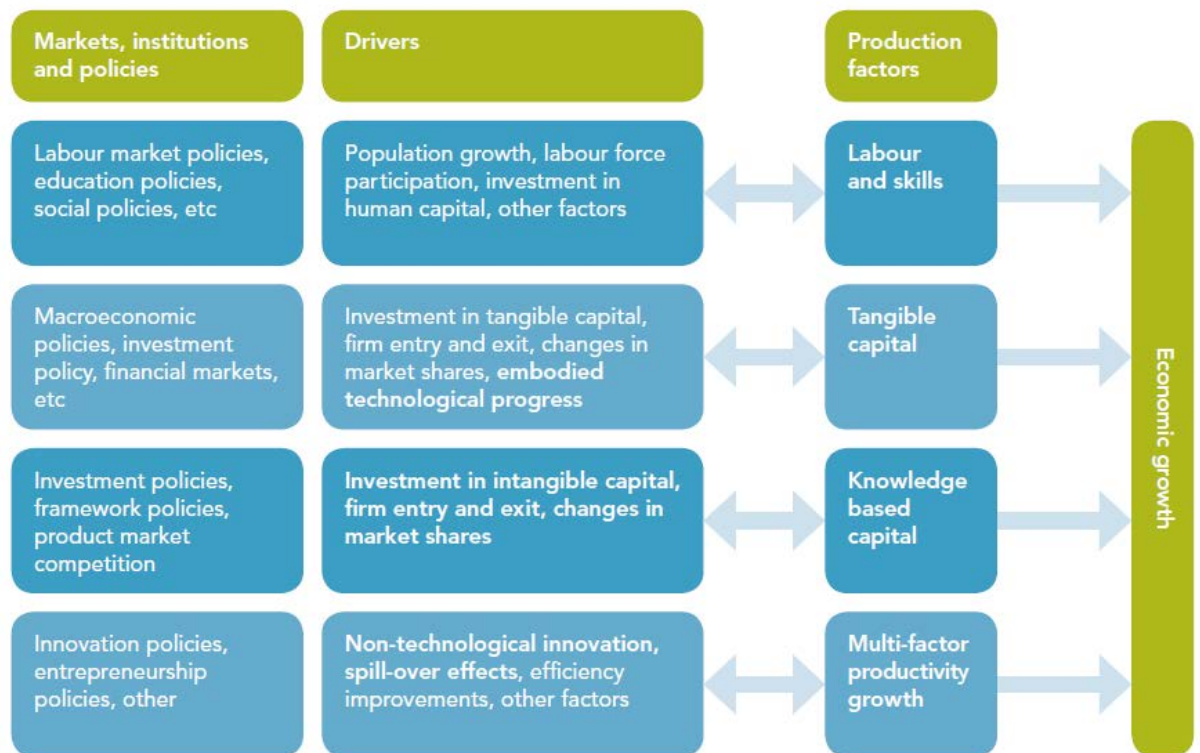
The main novel measure in the Innovation Statement is the upfront angel investor tax credit. There is no doubt that as a tax planning measure, this may be very attractive to high income earners, especially those that already have maxed out their superannuation funds, paid off their substantial home and negatively geared a rental investment property. Perhaps this will be too risky for many, although it is hard to see it as more risky than many agri-business schemes. Circular funding with debt can no doubt be arranged. Looking further afield for tax planning techniques, high income taxpayers will find here the ability to shelter more than \$400,000 a year of taxable income from tax (in exchange for a \$1 million



investment). Immediately, that is a substantial reward for risk. The challenge for marketers of the angel investment tax credit will be finding investments that are as risk-free as possible for their investors.

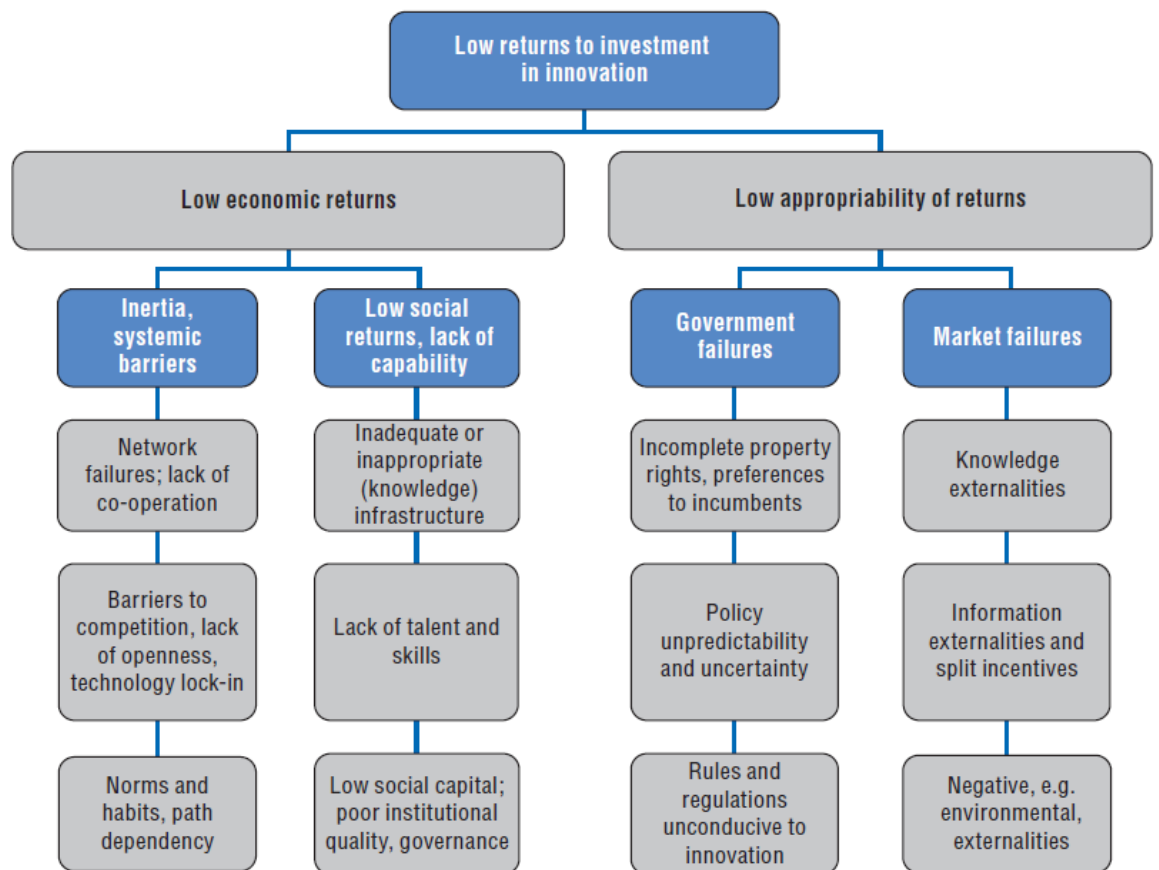
It seems to me that most of the venture capital and business tax investors are still likely to miss the mark. We need to take seriously the challenge of business taxation in a global era, especially for mobile production, manufacturing and intangibles activities: Entrepreneurs already are, and will continue to, look elsewhere for attractive tax rates.

**Figure 1: A production function framework for analysing economic growth**



Source: (OECD 2015, 18).

**Figure 1. Reasons for government innovation policies**



Source: (OECD 2015, 26).

## Appendix

### Case 1: *The Bikini Bonanza*

Philips C “Triangle swimwear takes beach by storm” January 9, 2016, *The Australian*, <http://www.theaustralian.com.au/life/fashion/triangl-swimwear-takes-beach-by-storm/news-story/0d4ba84084e590baf4e5b1fd48b0eb4d>.

**“It’s a classic rags-to-riches tale, version 2.0. Boy, broke, meets girl, they fall in love and, with little to their names except one another and a big dream, sell everything they own on eBay and throw the proceeds into a start-up.**

In 2012, former AFL footballer Craig Ellis and fiancée Erin Deering left the comfort of their home in Melbourne and bought a one-way ticket to Hong Kong. Their plan: to launch a swimwear line. Money was so tight, they ate canned food and packed orders from their tiny apartment. “We would run to the post office with three big tubs of bikinis and hold up the line for two hours processing the packages one by one,” says Ellis. ... Momentum picked up, and by April 2013 they were shipping more than 100 orders a day. Just two years later, *BRW* Rich List anointed Deering the second wealthiest woman in Australia under 40 with wealth of \$36 million.

In a market where up to 90 per cent of start-ups fail, and even compared with the 10 per cent that don’t, Triangl’s success isn’t just pat-on-the-back; it’s stratospheric.

The brand was born from a gap in the market. “There were the big swimwear labels like Seafolly, but nothing much in the \$100 category aside from surf brands,” says Ellis. They initially started wholesaling but in 2013 moved entirely online, selling only through their website, triangl.com. Ellis credits this move as the key to their success. ...

Launching Triangl was a big risk and Ellis didn’t have the best track record. He went bankrupt in 2009 after St Lenny, the T-shirt brand he founded with fellow AFL player Nathan Brown, folded. Ellis rode a pushbike to work and earned minimum pay, all the while keen to sink his teeth into another design business. Hong Kong appealed because of its proximity to the powerhouse Chinese factories, which somewhat avoided the delays and difficulties Australian designers faced when manufacturing locally.

“Instead of going straight to market with a perfect product, like so many brands do, we tested the waters with small batches. It enabled us to gauge the response of customers, and because we weren’t doing large runs we were open to experimenting,” Ellis says of the independently owned company. They tried two fabrications — neoprene and nylon-spandex. Contrary to their expectations, the former won out. “We weren’t going to argue with the customer, so that’s what we went with.” ...

“It’s grown way beyond anything we ever imagined,” says Ellis. He and Deering have a supply-chain office in Hong Kong with a staff of 10, and a parent company based in the Channel Islands where “all the decision-making happens”. Ellis plans to open a design office in New York.

After an initial six paid blogger posts, they had no marketing budget, so the couple turned to Instagram. ... Twitter posts prompted a sales surge in the US. It’s the strongest market at the moment, but Triangl ships everywhere and has processed orders from Kazakhstan and Mongolia. ...

While Triangl’s colour-blocked, back-trimmed styles are hardly breaking new fashion ground, they are distinctive and, unfortunately, easy to copy. ... It’s also happening on home soil. ... Australian swimwear label Baku and retailers Bras N Things and Target have ranges heavily inspired by Triangl’s popular balconette Milly and Poppy designs.

Away from the business, Ellis and Deering have just moved to Monaco with their baby, who at seven months has been on 28 international flights — first class, of course. “It’s not a bad life,” says Ellis, and his wife’s Instagram account bears this out, chronicling a whirlwind of luxury shopping, designer shoes and five-star island resorts. The lifestyle appears enviable, but there’s no such thing as work-life balance for these entrepreneurs. ...”

**Case 2: Emma in the Innovation Statement** (DPMC, 2015, p. 9)



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