



EG

**SUBMISSION TO
THE FEDERAL
GOVERNMENT ON
PROPOSED BUDGET
TAX CHANGES**

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EG FUNDS

The Government deserves credit for tackling long overdue equity issues associated with Australian taxation.

But some unintended and perverse consequences have not been adequately thought through by Treasury.

This paper addresses:

1. CGT on Startups and VC investments
2. Taxation of Discretionary Trusts

1. CGT on Startups and VC Investments: A CGT Carve-out for Startup Founders/ESOP Employees as well as VC.

The existing CGT regime (50% discount) for all existing and new startup investments should be maintained. This will cause the least disruption to Australia's innovation ecosystem.

Just as the government sees merit in exempting new dwellings from the CGT and negative gearing reforms - there is likewise a strong case for continuing to tax capital gains from startup equity under the existing CGT regime (50% discount).

The case for exempting start-up equity is based on the following:

- **Fairness.** Startup equity is fundamentally different from passive investment in property and shares. Startup formation represents active risk-taking, job creation and innovation. Treating startup and passive investment identically is flawed and unfair.
- **Binary return profile.** Unlike property and share investment, startup returns are binary and highly polarised. Most startups deliver a -100% return for founders, ESOP holders and investors (in other words, they fail). Only about 10% deliver out-sized returns, typically 3-10x the original investment. There's very little in the middle ground.
- **Founders.** Founders typically subscribe for shares in a startup at nominal cost (in return for nil or substantially below-market salaries for the first 3-7 years of the startup). Indexation of a near-zero cost base provides almost no benefit. The effective rate on capital gains for founders is therefore likely to move from approximately 23.5% (under the 50% discount) to circa 47% (since indexation affords almost no cover).
- **ESOP-holders.** Employee share ownership plans (ESOPs) are critical for startups competing for talent against large firms offering higher cash salaries. The CGT discount was central to the economics of accepting equity in lieu of wages. If ESOP capital gains are to be indexed from the date of issue, the financial logic of accepting equity in lieu of wages collapses. ESOP participation would become significantly less attractive.
- **VC investors & incubators.** Early-stage VC investors and incubators typically provide seed capital and pre-Series A capital at modest pre-money valuations. Indexation of a modest cost base provides little benefit. For high-growth, shorter-hold exits typical of venture capital, the effective rate on capital gains for investors is therefore likely to move from approximately 23.5% (under the 50% discount) to circa 42-45% (since indexation affords little cover).

- **ESIC.** Australia's tax system already offers qualifying early-stage investment companies (ESIC) a 10-year holiday on capital gains. These regimes recognise the public benefit of early-stage investment. Removing the 50% discount for investments outside those regimes undermines the broader ecosystem.
- **Timing considerations.** Allowing startups the CGT discount on valuations as of 1 July 2027 is not sufficient cover for startups formed since 2020 who have struggled to survive and achieve traction through recent shocks including COVID-19, geopolitical conflicts, supply-chain disruptions, higher inflation and higher interest rates. Most startups founded after January 2020 are today still languishing on low valuations and negative returns. The prospect of paying near 50% tax on capital gains above current valuations would be highly dispiriting.
- **Contentious valuations.** There are also practical objections. Startup shareholders will all need to obtain market valuations for their holdings as of 1 July 2027. That is manageable for real estate and listed shares, but much more complex and subjective for early-stage private companies and minority interests. Retaining the CGT discount for startups would avoid contentious valuations of this kind.
- **International competitiveness.** There is a further, largely overlooked consequence of the CGT reforms as they apply to startups: the changes will systematically advantage foreign investors over domestic investors in Australian startups. Under Australia's foreign resident CGT rules (Division 855), non-residents are only subject to Australian CGT on "taxable Australian property" - primarily real property and interests in property-rich entities. Startups are not typically taxable Australian property. This means a foreign investor who sells their stake in a successful Australian startup generally pays no Australian CGT whatsoever on the gain. This creates a perverse incentive structure: an Australian angel investor or founder is now taxed significantly more heavily on exactly the kind of high-risk, productive investment the government claims to want to encourage, while a foreign investor in the identical company, bearing the identical risk, pays nothing in Australia (and potentially very little in a tax-friendly foreign jurisdiction). The practical effect of this would be to tilt the playing field further toward offshore ownership of Australia's innovation economy - an outcome directly at odds with the government's stated objectives of promoting a domestic innovation ecosystem.

Indexation of a near-zero startup cost base provides almost no relief to domestic investors, while foreign investors in non-property-rich companies continue to pay nothing in Australia. The reforms effectively penalise domestic risk capital relative to offshore capital in precisely the asset class - high-growth startups - where Australia most needs to encourage domestic investment.

2. Taxation of Discretionary Trusts

From 1 July 2028, trustees of discretionary trusts will pay a minimum tax of 30% on the trust's taxable income at the trustee level.

When this change was announced in the budget, most people including HNW families accepted that change as fair. It:

- (a) places a minimum tax rate of 30% on all distributions to corporate beneficiaries (even if the prevailing company tax rate is 25%);
- (b) effectively puts an end to trust distributions to family members on little or no income; and
- (c) ends the benefit of accruing to any distributions to group companies with a tax loss.

2.1. Comment

The reception by HNWs to the change was surprisingly benign because it was seen as improving equity in our tax system.

But what we all did not know at the time because the Treasurer's speech did not make it clear - was the way in which distributions to corporate beneficiaries would be treated.

Under the proposed new rules, in respect of distributions by discretionary trusts:

- Non-corporate beneficiaries receive non-refundable tax credits for the 30% tax paid by the trustee. If a beneficiary's marginal rate exceeds 30%, they pay top-up tax. If their rate is below 30%, the excess credit is lost (non-refundable).
- Corporate beneficiaries, on the other hand, do not receive any credit for the 30% trustee-level tax paid. No coherent rationale is provided for this punitive tax treatment.
- No grandfathering applies - all existing discretionary trusts are captured from 1 July 2028.

This represents a fundamental departure from the longstanding "flow-through" character of trust taxation under Division 6 where beneficiaries - not the trust - are assessed at their own marginal rates.

2.2. Budget's Stated Rationale

The budget proposes to deny corporate beneficiaries any credit for the 30% minimum tax paid at the trustee level.

The Treasury fact sheet (Minimum Tax on Discretionary Trusts, 12 May 2026) addresses the rationale in two separate passages.

First, on the mechanism: "To ensure the use of refundable franking credits does not undermine the minimum tax: trustees that receive franked dividends will be required to use their franking credits to pay the minimum tax; and corporate beneficiaries will not receive non-refundable credits for tax payable by the trustee, to avoid them converting these to refundable franking credits to avoid the minimum tax."

Second, under a dedicated “Corporate beneficiaries” heading: “Under the minimum tax, corporate beneficiaries will be assessed based on the trust income to which they are entitled, without being able to claim credits for tax payable by the trustee. This will ensure the minimum tax cannot be avoided by cycling income through a ‘bucket’ company.”

The fact sheet further notes that of the approximately 80,000 companies receiving trust distributions in 2022–2023, 83% “did not have evidence of business activity, suggesting they operate primarily for tax purposes.”

The government’s stated intent is therefore not merely to close a franking credit loophole, but to actively discourage the use of corporate beneficiaries altogether - a point made explicit in the fact sheet’s conclusion that the measure “will reduce the incentive for trustees to distribute to corporate beneficiaries set up just to receive trust distributions from discretionary trusts.”

2.3. Bucket Companies.

It’s prejudicial to refer to corporate beneficiaries of discretionary trust distributions as “bucket companies”. It’s a pejorative term that implies wrongdoing.

Under current law, discretionary trusts commonly distribute income to corporate beneficiaries - typically, companies within the family group. These distributions are taxed at the company’s 25% or 30% corporate tax rate, and the tax paid generates franking credits that can be passed to shareholders when dividends are subsequently paid. This is entirely in keeping with Australia’s dividend imputation system, introduced in 1987 by Treasurer Paul Keating to eliminate the double taxation of corporate profits.

There is no mischief in this arrangement. This is why the business community was shocked by the punitive treatment accorded by the budget to such distributions.

2.4. An Alternative Solution.

If the aim of these measures is to stop corporate beneficiaries from paying the 30% minimum tax through their accumulated franking credits balances - this can be readily achieved by explicitly prohibiting the use of franking credits for this purpose. This would compel companies (or trustees on their behalf) to pay the minimum 30% tax in cash. But to deny corporate beneficiaries additional franking credits for the tax paid, doesn’t make sense.

2.5. The Case Against Denying Tax Credits to Corporate Beneficiaries.

The proposed tax treatment of corporate beneficiaries effectively demonises the use of trusts - for no legitimate reason.

The arguments against punitively taxing corporate beneficiaries are compelling:

- **Violation of the imputation principle.** Australia's dividend imputation system was introduced to ensure that income earned through a company is only taxed once at the individual shareholder's marginal rate, with corporate tax being a pre-payment (credited via franking). Denying any recognition of trustee-level tax for corporate beneficiaries explicitly creates double taxation - first at the trustee level (30%) and again at the company level (25% or 30%). (It is noteworthy that when Keating introduced the franking credit change in 1987, he did so despite Treasury objections, which he dismissed as unworldly.)
- **Punitive effective tax rates.** A distribution to a corporate beneficiary would be taxed first at 30% by the trustee, and then the remaining 70% taxed again at the 30% corporate rate - producing a combined corporate-level tax rate of 51%. When the company eventually distributes those profits as dividends to an individual shareholder on the top marginal rate, the total effective tax rate rises to approximately 62.9%. Under an alternative interpretation where the company pays 30% on the full grossed-up amount, the effective rates climb to 60% at the corporate level and 69.7% on ultimate distribution.
- **Inconsistency and unfairness.** The proposed measure creates a situation where the same dollar of income attracts dramatically different tax treatment depending solely on whether it flows through a discretionary trust or a company. If a company owns shares in a business and that business distributes an unfranked dividend, it will pay tax at the company tax rate and receive a franking credit. But if a trust owns the same business and receives the same unfranked dividend, it would be required to pay a minimum tax of 30% and would receive no franking credits. That is patently unfair.
- **Perverse incentive structure.** If the goal is to discourage income splitting to low-rate beneficiaries, the measure already achieves this through the 30% minimum tax with non-refundable credits to individuals. The additional punishment directed at corporate beneficiaries goes beyond this purpose and creates a perverse incentive to dismantle legitimate structures, even where corporate beneficiaries serve genuine commercial purposes (e.g., retaining earnings for reinvestment, managing cash flow, or isolating liabilities).
- **Challenging the Treasury's characterisation.** The Treasury fact sheet notes that of the approximately 80,000 companies receiving trust distributions in 2022–23, 83% "did not have evidence of business activity, suggesting they operate primarily for tax purposes." This flies in the face of common sense and lived experience. Almost all corporate beneficiaries become investment vehicles and derive taxable business income from these investment activities. Treasury has conveniently sought to characterise investment activity as something other than a "business activity".
- **Rollover relief for corporate restructures.** Almost all income producing assets and interests in private companies will need to be transferred from discretionary trusts to companies and individuals - if double taxation is to be avoided. This will create a mountain of unproductive tax restructuring, upheaval and stress for taxpayers and will necessitate stamp duty relief that is complex and expensive to administer. All this to achieve an outcome that could be achieved more simply by denying corporate beneficiaries the ability to pay the minimum tax by using prior franking credits.



Final Observation

These suggestions are put forward in the spirit of forging a fair outcome based on principle of equitable tax reform which assists in growing productivity and stimulates economic dynamism and endeavour.

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