Opinion

CGT changes could make government a 50:50 partner in your start-up

A policy sold on fairness may do the worst damage to people Australia most needs to back: founders, risk-takers and employees with a genuine stake in the upside.

Shaun Cartoon *Tax lawyer*

May 6, 2026 – 4.48pm

Budget night may yet produce a more modest reform than current speculation suggests. The government may reduce the capital gains tax discount, quarantine changes to housing, grandfather existing investments or do nothing. We will have to wait and see.

But if the 50 per cent CGT discount is removed and replaced with indexation, this would be the most significant change to the taxation of private capital in a generation. Titans of Australia's tech industry tell me they are very worried.

The few start-ups that succeed – like Richard White's WiseTech Global – must compensate founders and early employees for years of below-market salaries, dilution and career risk. **Bethany Rae**

Taxing inflationary gains is poor policy, so there is a respectable argument for indexation. But tax systems are judged by behaviour, not theory. The question is what indexation does to risk capital, founders, employees and capital allocation.

The relative winner would be superannuation, assuming super funds remain outside the change. If the personal CGT discount disappears, the incentive to move long-term savings into super becomes stronger. That may be good retirement policy, but it is not neutral tax policy.

As *The Australian Financial Review* deputy wealth editor, Michelle Bowes, pointed out in her article recently, the biggest losers would be young Australian founders trying to build globally significant companies. For them, indexation is practically useless. A founder's cost base is usually nominal.

Two ordinary shares issued for $1 each do not become meaningfully more valuable as a tax cost base merely because they are indexed for inflation.

Take an entrepreneur who incorporates a company with two $1 shares and later sells it for $1 billion. Under the current discount, assuming the top marginal tax rate applies, the tax on the gain is about $235 million. Without the discount, and with indexation doing almost nothing to a $2 cost base, the tax is about $470 million.

That changes the government from a tax collector into something closer to a 50:50 economic partner in every new start-up in the country, except without taking the early commercial risk, making payroll, raising seed capital or sitting through failed product launches.

"The CGT discount is one of the only elements of the Australian tax system that makes it globally competitive."

Start-ups are not ordinary investments. Most fail. The few that succeed must compensate founders and early employees for years of below-market salaries, dilution and career risk. If Australia wants founders to take that risk here, the after-tax reward must be internationally competitive.

The same problem applies to employee share schemes. The Turnbull-era innovation reforms were built around a practical proposition: start-up employees could receive options or shares at an early, low valuation, with the major upside taxed later as a capital gain.

That made sense where a 50 per cent CGT discount was available. It makes much less sense under indexation.

Many start-up options have an exercise price linked to a low valuation, often using a company's net tangible assets as the basis for the methodology.

A low exercise price is valuable when the upside receives CGT discount treatment. It is far less attractive if almost the entire upside is ultimately taxed at up to 47 per cent. That would undermine one of the few parts of Australian tax policy deliberately designed to support innovation, and which has been quietly flourishing.

The transitional rules will be critical. Full grandfathering delays budget repair and preserves existing inequities. No grandfathering punishes taxpayers who made long-term decisions under one set of rules.

A hybrid rule, reported by economics editor John Kehoe in his article, where the discount applies to gains accrued up to budget night and indexation applies thereafter, may look like a compromise. But it would create an incentive for some founders and investors to sell sooner than they otherwise would. It also does not prevent the significant disadvantage arising from the change to the concessional capital gains tax treatment underpinning the start-up tax concessions.

For serial founders, it may also affect the more important decision: whether the next company should be started in Australia at all.

The CGT discount is one of the only elements of the Australian tax system that makes it globally competitive. While countries like Italy, the United Arab Emirates and Singapore have introduced major tax incentives to move there, removing the CGT discount would create an incentive for founders to leave Australia.

The broader capital allocation effects should not be underestimated. If short and medium-term capital gains are taxed in substantially the same way as income, some investors will rotate from growth assets into yield assets: private credit, mortgage-backed securities and high-risk property development. The tax system should be careful before pushing capital away from productive equity risk and towards debt-like returns.

Investors will also search for assets that remain exempt or concessional: the main residence, early-stage innovation company investments, early-stage venture capital limited partnerships and offshore life bonds. Structurally, expect more use of companies to cap the first layer of tax at 25 per cent or 30 per cent, even though that brings complexity and later distribution issues.

There is a case for taxing real gains rather than inflation, and for addressing housing affordability and intergenerational unfairness.

But abolishing the CGT discount across the board would be a blunt instrument. If the government wants to change the rules, it should do so with precision. Otherwise, a reform sold as fairness may end up doing the most damage to the people Australia most needs to back: founders, risk-takers and employees with a genuine stake in the upside.

RELATED

Federal budget

'Catastrophic': Start-ups warn against CGT change

Capital gains tax

Who wins and loses in a switch to an inflation-adjusted CGT discount?

Shaun Cartoon is a partner in Arnold Bloch Leibler's tax practice.