OVERVIEW OF TAX INCENTIVES FOR EARLY STAGE INVESTORS

azure group

Overview of Tax Incentives for Early Stage Investors

- Part of Malcom Turnbull’s National Innovation & Science Agenda
- Law finalised on 5 May 2016. Start time 1 July 2016 *(ie 2017 financial year)*
- Broadly, provides investors with:
  - ❑ a tax offset of 20% of amount invested (subject to limits); and
  - ❑ full Capital Gains Tax exemption on those shares (for shares held between 1-10 years)

Who is eligible?

- All types of entities are potentially eligible, including:
  - Individuals
  - Companies (unlisted, non-widely held)
  - Trusts; and
  - Partnerships

Requirements

- Investor makes new equity investment
- Company satisfies extensive Early Stage Innovation Company (ESIC) requirements see below
- Investor and company are not affiliates
- Not part of an employee share scheme
- After the share issue, investor must not hold more than 30% of the ESIC or a connected entity of the ESIC

Limits on the offset

- ❑ $200,000 if "sophisticated investor"
- ❑ $10,000 otherwise

What kind of shares are eligible

- Any kind of shares issued by the ESIC is eligible, provided that they satisfy the tax law definition of equity interests

- Therefore certain redeemable shares need to be examined carefully

Trusts & partnership investors

- Can stream the offset to specific partners/beneficiaries unless the capital entitlements are fixed

- Trustee or partnership must provide written notice of determination to beneficiary/partner within 3 months after financial year end

CGT Exemption

- Full Capital Gains Tax exemption on shares that are entitled to the tax offset (if held between 1-10 years)
- Investor gets market value cost base at year 10
- Even applies to investments by sophisticated investors exceeding the tax offset cap (but not to other investors who exceed the $50,000 investment cap)
- No capital loss within 10 years
- CGT exemption is preserved under some rollovers but not others

The main hurdle, meaning of "Early stage innovation companies"

- Time-based requirement – not as simple as just less than 3 years incorporation. Older companies <u>may</u> still satisfy requirements.
- Expenses requirement – ESIC and subsidiaries' total expenses <u>cannot exceed $1m</u> in the previous income year
- Assessable income requirement – ESIC and subsidiaries' total assessable income <u>cannot exceed $200K</u> in the previous income year
- <u>Unlisted</u> requirement
- 100 points-based test <u>or</u> principles-based test

100 points based test

POINTS	CONDITION
75	At least 50% of company expenses for previous income year are eligible for R&D tax incentive
75	Accelerating Commercialisation Grant (Entrepreneurs' Program)
50	More than 15% and less than 50% of company expenses for previous income year are eligible for R&D tax incentive
50	Company completed or is undertaking an accelerator program that: ❑ Provides time-limited support ❑ Competitive ❑ Accelerator has been operating for at least 6 months ❑ At least one cohort has completed the program
50	Company raised at least $50,000 equity funding from non-related entities
50	Company was granted a standard patent in last 5 years
25	Company was granted an innovation patent in last 5 years
25	Company has written agreement with research institutions

Principles-based test

- New or significantly removed
- High growth potential
- Scaling potential
- Broader than local market
- Competitive advantages

Complexities

- Investor strike – mechanisms to accept the investor money now
- $200,000 tax offset cap applies to investor and their “affiliates”

What startups need

- Structuring and planning to ensure the criteria are satisfied
- Signoff on ESIC criteria to give investors comfort
- Administration and reporting requirements

What investors need

- Accountant’s certificate that they satisfy the meaning of “sophisticated investor”