

Tax incentives for investors in Early Stage Innovation Companies

As part of the Government's broader plan to encourage innovation in Australia, investors in Early Stage Innovation Companies (ESICs) will have access to certain tax concessions. Are you eligible?

What are the incentives?

- 20% non-refundable carry forward tax offset (capped at \$200K i.e. \$1m investment)
- Modified CGT treatment:
 - shares held for at least 12 months and less than 10 years (capital gain disregarded)
 - shares held for less than 10 years (capital loss disregarded)
 - market value cost base applies at end of 10 year period.

Qualifying criteria: Investor

Investors must meet the following requirements to be eligible for tax concessions:

- Purchased shares after 1 July 2016 in a qualifying Early Stage Innovation Company (ESIC) – has to be through newly issued shares, not transferred shares
- Shares are equity interests in the company
- The investor is not a widely held or listed company
- Total investment is not more than \$50K if non-sophisticated investor¹. No cap on investment for sophisticated investor
- The investor and the ESIC are not affiliates of each other at the time the shares are issued
- The investor holds no more than 30% of the equity interests in the ESIC
- The investor didn't acquire the shares through an ESS.

Other notes

Offset flows through to underlying members of partnerships/trusts, and investors can be residents or non-residents.

Qualifying criteria: ESIC

An ESIC needs to meet both of the following to be eligible:

- The early stage test; and
- Either 100 point innovation test or principles based innovation test.

Early stage test

There are four requirements in an early stage test:

1. The company must have been incorporated or registered in the Australian Business Register
2. The company (plus any wholly-owned subsidiaries of the company) must have total expenses of \$1 million or less in the previous income year
3. The company (plus any wholly-owned subsidiaries of the company) must have assessable income of \$200,000 or less in the previous income year
4. The company's equity interests are not listed for quotation in the official list of any stock exchange, either in Australia or a foreign country.

100 Point Innovation test

See Appendix B. Note that this operates by accumulating at least 100 points from the factors listed. It is not necessary to satisfy each of the factors.

¹ See definition in Appendix A

Principles Based Innovation test

Company must meet the following five requirements:

1. The company must be genuinely focused on developing one or more new or significantly improved innovations for commercialisation
 - 'Commercialisation' includes a range of activities that involve the implementation or sale of a new or significantly improved innovation that will directly lead to the generation of economic value for the company.
2. The business relating to that innovation must have a high growth potential
 - Need to have a broad assessable market
 - Potential for growth nationally and/or globally
3. The company must demonstrate that it has the potential to be able to successfully scale up that business
 - Should be able to leverage of its existing costs to increase revenue
4. The company must demonstrate that it has the potential to be able to address a broader than local market, including global markets, through that business.
 - Must have a market broader than its local area
5. The company must demonstrate that it has the potential to be able to have competitive advantages for that business.
 - Potential to have competitive advantage
 - Provides unique benefits
 - Measure the level of value provided to customers relative to its competitors

Reporting and ruling

Companies need to report information to the ATO if new shares have been issued which could lead to an investor being entitled to the incentives. Reporting must be done via a form (yet to be released) by 31 July each year for new shares issued in the previous year. i.e. for any shares issued in the 2017 income year, the form needs to be submitted to the ATO by 31 July 2017.

Companies can apply for a ruling about whether they meet the 100 point innovation test or Principles Based Innovation Test.

Find out more

If you're interested in finding out if these concessions may apply to your circumstances, or if you have any questions, please contact either Abi Chellapen or Helen Wicker to discuss.

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Appendix A

Examples of what defines a sophisticated investor

- Certificate issued by a qualified accountant (in the last 6 months) confirming you have gross income of at least \$250K for each of the last 2 financial years and net assets of at least \$2.5m
- Paid at least \$500k for the qualifying shares
- You are offered the qualifying shares through a financial services licensee who is satisfied that you have previous investment experience
- Professional investor such as a financial services licensee
- Control gross assets of at least \$10m including assets held by associates

Appendix B

100 Point Innovation Test - as per the legislation

Innovation points potentially available at that time in the current year		
Item	Points	Innovation criteria
1	75	At least 50% of the company's total expenses for the previous income year is expenditure that the company can notionally deduct for that income year under section 355-205 (about R&D expenditure).
2	75	The company has received an Accelerating Commercialisation Grant under the program administered by the Commonwealth known as the Entrepreneur's Programme.
3	50	At least 15%, but less than 50%, of the company's total expenses for the previous income year is expenditure that the company can notionally deduct for that income year under section 355-205 (about R&D expenditure).
4	50	(a) the company has completed or is undertaking an accelerator program that: <ul style="list-style-type: none"> (i) provides time-limited support for entrepreneurs with start-up business; and (ii) is provided to entrepreneurs that are selected in an open, independent and competitive manner; and (b) the entity providing that program has been providing that, or other accelerator programs for entrepreneurs, for at least 6 months; and (c) such programs have been completed by at least one cohort of entrepreneurs.
5	50	(a) a total of at least \$50,000 has been paid for *equity interests that are *shares in the company; and (b) the company issued those shares to one or more entities that: <ul style="list-style-type: none"> (i) were not *associates of the company immediately before the issue of those shares; and (ii) did not *acquire those shares primarily to assist another entity become entitled to a *tax offset (or a modified CGT treatment) under this Subdivision; and (c) the company issued those shares at least one day before the test time.
6	50	(a) the company has rights (including equitable rights) under a *Commonwealth law as: <ul style="list-style-type: none"> (i) the patentee, or a licensee, of a standard patent; or (ii) the owner, or a licensee, of a plant breeder's right; granted in Australia within the last 5 years (ending at the test time); or (b) the company has equivalent rights under a *foreign law.
7	25	Unless item 6 applies to the company at the test time: (a) the company has rights (including equitable rights) under a *Commonwealth law as: <ul style="list-style-type: none"> (i) the patentee, or a licensee, of an innovation patent granted and certified in Australia; or (ii) the owner, or licensee, of a registered design registered in Australia; within the last 5 years (ending at the test time); or (b) the company has equivalent rights under a *foreign law.
8	25	The company has a written agreement with: (a) an institution or body listed in Schedule 1 to the Higher Education Funding Act 1988 (about institutions or bodies eligible for special research assistance); or (b) an entity registered under section 29A of the Industry Research and Development Act 1986 (about research service providers); to co-develop and commercialise a new, or significantly improves, product, process, service or marketing or organisational method.