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Article Information

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Defining criteria for tax incentives for early stage investors

As part of the Government's National Innovation Agenda, the Government released a Policy Discussion Paper on proposed tax incentives for early stage investors.

As part of the Government's National Innovation Agenda, the Government released a Policy Discussion Paper on proposed tax incentives for early stage investors. This gives some guidance on how the incentives will work.

To encourage early stage investment into innovative Australian companies, the tax incentive will provide investors with the benefit of a non-refundable tax offset and a capital gains tax exemption on investments that meet certain eligibility criteria.

The availability of the tax incentive will depend on various critical qualifying definitions. These definitions are considered in the Policy Discussion Paper. ***Partner, David Cornwell*** *and* ***Senior Associate, Kimberley Levi*** *discuss the Policy Discussion Paper.*

Eligible Australian Innovation company

The tax incentive will only be available for investments into Australian innovation companies that meet the prescribed eligibility criteria. The eligibility criteria is therefore critical to start-ups looking to attract early stage investors.

As defined in the Policy Discussion Paper, an eligible Australian innovation company must:

- be incorporated in Australia during the last 3 income years
- have assessable income of $200,000 or less and expenditure of $1 million or less in the prior income year
- not be listed on any stock exchange.

In addition to the above, it is proposed that the company must:

- meet a principles-based test. This will assess whether the company is innovative, having a new or significantly improving an existing idea, the ability to generate value from the idea, the ability to pursue global markets and a suitable management team capable of high growth,
- meet a minimum number of gateway and safe harbour tests. These may include, for example, tests relating to a threshold of research and development claims, acceptance into approved accelerator programs, third party financial investors and existing support through Commonwealth or State Government programs, or
- obtain a "determination" from the Australian Taxation Office that the company qualifies.

In addition to the above, it is proposed that there will be a list of investment activities which will be explicitly excluded from accessing the tax incentive.

Direct and indirect investments

The incentive will be available to both direct and indirect investors, being:

- investors that invest money directly into an eligible Australian innovation company in exchange for new shares in that company
- investors that invest through vehicles that are regarded as an "eligible innovation fund".

As to direct investors, there is a proposal to limit the availability of the tax offset to sophisticated investors. This proposal has the benefits of protecting unsophisticated investors from being misguided into investing in high risk investments and reducing costs for eligible Australian innovation companies by reducing disclosure requirements. However this disadvantages “small” investors, preventing them from having the benefit of the tax incentive.

As to indirect investments, eligible innovation funds will be limited to a companies that carry on the sole business of purchasing shares that are equity in eligible Australian innovation companies. The innovation fund must have no more than $50 million committed capital at fund close, no more than $50 million invested in innovation companies at any one time, hold no more than 30% of the issued capital in an innovation company, and have no more than 10% of its committed capital in any single innovation company. Questions remain as to required structure of the innovation fund and the timing of the administration of the tax offset for indirect investors.

The incentive

Direct and indirect investors that satisfy the investor criteria and invest in an eligible Australian innovative company will have the benefit of:

- a 20% non-refundable tax offset of up to $200,000 in an income year
- a 10 year capital gains tax exemption on the disposal of the shares in the eligible Australian innovative company, subject to those shares being held for at least 3 years.

Interested parties are invited to comment on the Policy Discussion Paper. The closing date for submissions is Wednesday, 24 February 2016.

We will provide further updates in due course.