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New tax incentives for innovation companies

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A shareholder in a company can now obtain tax incentives for investing in a qualifying early stage innovation company. Both Australian resident and non-resident investors can obtain the tax incentives. The tax incentives, introduced on 1 July 2016, are designed to encourage investment in Australian innovation companies. The 2 new incentives as broadly as follows:

- a non-refundable tax offset equal to 20% of the amount paid for the qualifying shares; and
- no CGT on share investments owned for less than 10 years.

What is an early stage innovation company?

For the 2 new tax incentives to be available, the company in which the shareholder is investing must be an early stage innovation company (**ESIC**). All the following conditions must be met for a company to be considered an ESIC:

Conditions		Comments
1	Company was formed in Australia in last 3 income years	'Formed' means either incorporated or registered with the Australian Business Register.

2	Assessable income (income that is subject to tax) of $200,000 or less, in the prior income year	Any amounts received under the Accelerating Commercialisation Grant may be ignored when calculating assessable income.
3	The company's expenditure must be $1 million or less, in prior income year	If a company has already lodged a tax return for the prior year, the amount entered under 'total expenses' in item 6 must be relied on for this test.
4	Not an entity listed on any stock exchange	This includes any stock exchange outside of Australia.

Who can obtain the incentives?

For a shareholder to be able to obtain the incentives, they must buy new shares in an ESIC on or after 1 July 2016. Also, the shareholder must buy the shares immediately after the shares are issued. This requirement is known as 'point-in-time' test.

However, an investor will not access the tax incentives, in the following situations:

Conditions		**Comments**
1	Investor does not buy shares directly from ESIC as newly issued shares	This measure is designed to ensure that the incentives are only received by investors who contribute to the company's ability to obtain additional funds.

2	Investor does not meet sophisticated investor test and total investment in qualifying ESICs in an income year is more than $50,000	As ESICs can be high-risk investments, this limits the exposure of retail investors to $50,000.
3	Investor becomes an affiliate with the ESIC immediately after shares are issued	The ATO defines the term ‘affiliate’ as an individual or a company who would carry out business or any related acts under investor’s direction
4	Investor holds more than 30% of shares in company, together with any entities connected with company	The ATO defines a connected entity as an entity that controls or is being controlled by an ESIC or a third party that is in control of both ESIC and the entity.
5	Investor buys shares under an employee share scheme	The new incentives are targeted at new investors rather than existing employee share schemes or interests with a debt character e.g. preference shares.
6	Investor is a widely held company or a wholly-owned subsidiary of a widely held company	A widely held company is either a listed company or a company with more than 50 shareholders.

A sophisticated investor can invest any amount in an ESIC but the investor cannot hold more than 30% of the shares in the ESIC or its connected entities.

Special rules apply to trusts and partnerships wishing to obtain the benefit of the tax incentives. The tax incentives may be available to SMSFs. However, SMSFs must ensure that they follow superannuation law before becoming shareholders in such companies.

2 types of incentives

Tax offset

A shareholder in an ESIC will obtain a 20% tax offset for their investment in the ESIC. Either the investor or their associates can claim the tax offset, however, the maximum offset available to each investor is $200 000 per year. In other words, qualifying investments by investors and their affiliates which are over $1 million in an income year will not increase the amount of the offset available to them.

On the other hand, if the sophisticated investor test is not met, then, the maximum tax offset amount that can be claimed is $10,000. The limit of the total annual investment for a non-sophisticated investor is $50,000.

CGT

No CGT will apply to shares owned in an ESIC for less than 10 years. In contrast to the cap on the tax offset, no cap applies to the CGT treatment of investments.

Conclusion

Tax incentives of the type recently introduced by the Australian Government have proven time and time again that they are capable of achieving desired outcomes for the Government and the community generally. If you would like advice on whether you can obtain the benefit of the new tax incentives, please contact batallion legal.