

Tax Insight

Big tax breaks for
investors in new
innovative companies

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Sophisticated investors in early stage innovative companies can receive a tax credit of 20% of their investment, up to a limit of \$200,000, and subsequent sale of the company shares will be capital gains tax free provided they are held for 12 months to ten years. There are also concessional capital gains tax outcomes if the shares are held for longer than ten years.

Smaller investors that don't meet the "sophisticated investor" test are eligible for the tax incentives only if their investment in early stage innovative companies is \$50,000 or less, for any particular tax year.

Question: What are the requirements to obtain these tax benefits?

Answer: Generally, you are entitled to the tax credit if:

- The innovation company issued you with shares
- The company meets the early stage and innovation tests
- The company and you do not act or nor could be reasonably expected to act in accordance with each other's directions or in concert with each other in relation to your or the company's business affairs except in any official roles (affiliates test)
- You are not a widely held company or subsidiary nor a trust or partnership
- The shares are not from an employee share scheme, and
- You hold no more than 30% of the total equity interest in the company after the share issue.

Where the shareholder is a trust or partnership, members of the trust or partnership may be entitled to the tax offset.

The tax offset is 20% of the total amount paid for the shares but cannot exceed to \$200,000 for a particular tax year or where any of the tax offset carries forward to a later tax year.

Where you are a retail investor, not a sophisticated investor, you can only access the tax incentives if you're investment in early stage innovation companies was no more than \$50,000 for a particular tax year. To be a sophisticated investor, generally, you must hold a certificate from a CPA or chartered accountant that confirms that you had gross income of at least \$250,000 in the last two financial years or that you hold net assets of at least \$2.5 million. Alternatively, you might meet the sophisticated investor test if it is an investment of \$500,000 or more, you hold the relevant certificate from a financial planner, you are a professional investor or you control gross assets of at least \$10 million.

Question: What is an early stage innovation company?

Answer: A company will meet this test in a particular tax year if:

- It was incorporated in Australia or registered on the Australian Business Register within the last three years or it was incorporated within the last six years and across the last three tax years it and any 100% owned subsidiaries incurred expenses of \$1 million or less
- The company and any 100% subsidiaries had total expenses of \$1 million or less in the year before the current year
- The company and any 100% subsidiaries had total assessable income of \$200,000 or less in the last year
- The company is not listed on a stock exchange, and
- The company meets the 100 points test, or as an alternate to the 100 points test
- The company meets the “principles” test.

Under the 100 point innovation test, companies accumulate points for participating in Research & Development activities, receiving an Accelerating Commercialisation Grant, completing an accelerator program, having at least \$50,000 in share capital including issuing shares to new non-associated investors, holding patent or plant breeder rights or having written agreements with a university to co-develop and commercialise new or significantly improved products, processes or services. The test is satisfied when 100 points are accumulated.

A company will meet the “principles” test if:

- It is genuinely focused on the commercialisation of new or significantly improved products, processes, services or marketing or organisational methods
- The business relating to those products, processes, services or methods has high growth potential
- It can demonstrate the potential to successfully scale the business
- It can demonstrate the potential to address a broader than local market, potentially internationally, and
- It can demonstrate the potential to have competitive advantages for the business.

Question: What are the capital gains tax incentives associated with the shares?

Answer: Where the investor was entitled to these tax offsets, the following capital gains tax incentives apply:

- The shares are taken to be held on capital account
- The investor must disregard any capital gain or capital loss from the sale of shares held for the period from 12 months to the tenth anniversary of the issue of the shares; and
- Where the shares have been held continuously for ten years, their cost base becomes the market value at that date.

Companies are required to complete an early stage innovation company report and lodge it with the Tax Office shortly after the end of each financial year to report any eligible share issues that have been made. The incentives were first available for share issues made in the year ending 30 June 2017.

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