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Topic 2: Capital Raising and CSEF

Background

- A company has the legal capacity and powers of an individual both in and outside this jurisdiction. A company also has all the powers of a body corporate, including the power to: (**s124 Corporations Act 2001**)
 - (a) **issue and cancel shares in the company;**
 - (b) **issue debentures** (despite any rule of law or equity to the contrary, this power includes a power to issue debentures that are irredeemable, redeemable only if a contingency, however remote, occurs, or redeemable only at the end of a period, however long);
 - (c) **grant options over unissued shares in the company;**
 - (d) distribute any of the company's property among the members, in kind or otherwise;
 - (e) grant a security interest in uncalled capital;
 - (f) grant a circulating security interest over the company's property;
 - (g) arrange for the company to be registered or recognised as a body corporate in any place outside this jurisdiction;
 - (h) do anything that it is authorised to do by any other law (including a law of a foreign country).
- A company limited by guarantee does not have the power to issue shares

Raising Capital

Step 1: Is it a Public or Proprietary Company?

- A company is a public company if it is not a proprietary company (**s9 Corporations Act 2001**)
- A company is a proprietary company if it: (**s45A(1) Corporations Act**):
 - is registered as, or converts to, a proprietary company under this Act (i.e. registered with ASIC)
 - (a) has **no more than 50** non-employee shareholders (not including shareholders connected with CSEF offers)
 - **CSF shareholders are not included** in that number (**ss45A(1)(a), 113(2)(c)**)
 - If CSF shares have been transferred to another entity and the 50 shareholder cap is breached, see **s113(2)(d)**
 - An **employee shareholder** is: (**ss113(2)(b)**)
 - (i) a shareholder who is an employee of the company or of a subsidiary of the company; **or**
 - (ii) a shareholder who was an employee of the company, or of a subsidiary of the company, when they became a shareholder.

If it is a proprietary company, is it a small or large proprietary company?

- A proprietary company is a **small proprietary company** for a financial year **if it meets at least two of the following** criteria (otherwise it is a large proprietary company): **(s45A(2))**
 - (a) the consolidated **revenue** of the company (and any entities it controls) for the financial year is **less than \$50 million; (r1.0.02B(1))**
 - (b) the value of the consolidated **gross assets** of the company (and any entities it controls) at the end of the financial year is **less than \$25 million; (r1.0.02B(2))**
 - (c) the company (and any entities it controls) have **fewer than 100 employees** at the end of the financial year **(r1.0.02B(3))**
- Benefits of small proprietary company:
 - Reduced regulatory requirements = lower operating costs
 - Not required to prepare audited financial reports or directors' reports unless expressly directed to do so by ASIC or by shareholders who have 5% of the voting power in the company

Step 2: What companies can raise capital?

- *Only public companies can issue shares to the public, but this is regulated by strict disclosure requirements in Ch 6D of the Corporations Act. Proprietary companies cannot do anything which requires them to issue disclosure documents under Ch 6D (s113(3)), subject to certain exceptions. On the facts, [X] is a proprietary/public company because:*
 - Limited by shares;
 - Have no more than 50 non-employee shareholders (**BUT, remove any CSF shareholders**);
 - Registered with ASIC
- *As such, [X] can/cannot issue shares to the public*
- **Public companies** can issue shares to public, but when doing this they must issue appropriate disclosure documents per **Ch 6D** → **Go to Step 3**
- **Proprietary companies must not** engage in any activity that would require disclosure to investors under **Chapter 6D** (i.e. raising capital from the public), **except** for: **(ss113(3), 45A(1)(b))**
 - (a) an offer of its shares to:
 - (i) existing shareholders of the company; **or**
 - (ii) employees of the company or of a subsidiary of the company; **or**
 - (b) a CSF offer

UNLESS an exception to **Ch 6D** applies → **Go to Step 4**

Step 3: Chapter 6D – Types and content of disclosure documents

- *[Public company] must adhere to disclosure requirements set out in Ch 6D of the Corps Act when offering an issue of securities (s706), unless the offer falls under any of the exceptions provided in s708*

- *[If offer is > \$10m] As the offer of securities exceeds \$10m, then [X] must issue a prospectus with the offer pursuant to s709(1). A prospectus must include [outline of information]. On the facts, the prospectus does/does not fulfil these requirements*
- *[If offer is < \$10m] As the offer of securities is less than \$10m, then [X] may issue an offer information statement instead of a prospectus (s709(4)). This statement must include [outline of information]*
- An 'offer of securities for issue', **other than a CSF offer**, needs disclosure to investors (s706), subject to the exceptions in s708
- To comply with disclosure requirements, **companies must issue appropriate disclosure documents and lodge these with ASIC**, with the type of document depending on the circumstances (s705):
 - **Prospectus:** A prospectus must be used in relation to all offers of securities over \$10m (s709(1))
 - Is a document which **must contain all the information that investors and their professional advisors would reasonably require to make an informed assessment** of the rights and liabilities attaching to the securities, as well as the assets and liabilities, financial position and performance, profits and losses, and prospects of the company that issues them (s710)
 - It must specifically set out (per s711):
 - (1) Terms and conditions of offer
 - (2) Disclosure of interests and fees of people involved in the offer
 - (5) Quotation of securities
 - (6) Expiry date of offer
 - (7)(a) That a copy of the prospectus has been lodged with ASIC and (b) that ASIC takes no responsibility for the content of the prospectus
 - **Offer information statement:** Where offers are of securities totalling \$10m or less, instead of a prospectus, the issuing company can use an offer information statement (s709(4))
 - Offer information statement must (s715(1)):
 - (a) Identify the body and nature of the securities;
 - (b) Describe the body's business;
 - (c) Describe what the funds raised by the offer are to be used for;
 - (d) State the nature of the risks involved;
 - (e) Give details of all amounts payable in respect of the securities;
 - (f) (i) State that the statement has been lodged with ASIC and (ii) that ASIC takes no responsibility for the content of the statement;
 - (g) State that the statement is not a prospectus and that it has lower disclosure requirements;
 - (h) State that investors should obtain professional investment advice before accepting the offer; and
 - (i) Include a financial report
 - (j) Include any other information that the regulations require to be included in the statement

- **Profile statement:** contains limited information and can only be used where ASIC has expressly permitted its use (**ss709, 714**)

Step 4: Exceptions to Ch 6D/ Raising capital as a proprietary company

- *Given that [X] is a proprietary company, it will generally be prohibited from issuing securities to the public as this would usually require disclosure documents per Ch 6D (s113(3))*
- *However, this prohibition does not apply if:*
 - *(1) the offer is to existing shareholders (s113(3)(a)(i));*
 - *(2) the offer is to its employees or employees of a subsidiary (s113(3)(a)(ii));*
 - *(3) it constitutes a CSF offer (s113(3)(b)); or*
 - *(4) the offer falls within one of the exceptions in s708*
- *If none of these exceptions apply, then it must convert to a public company and issue the appropriate Ch 6D disclosure documents (s113(3))*

Exception 1: Small-scale personal offer exception: **s708(1)-(7)**

- **Personal offers** of securities **do not require disclosure** if the offer does not result in more than:
 - (a) 20 new investors being issued shares in any 12-month period (**ss708(1)(a), (3)(a) if offer made by company, or ss708(1)(a), (4)(a) if offer made by person to transfer securities**); **and**
 - (b) no more than \$2 million being raised in any 12-month period (**ss708(1)(b), (3)(b) if offer made by company, or ss708(1)(b), (4)(b) if offer made by person to transfer securities**)
- Per **s708(2)** '**Personal offers**' are ones that:
 - (a) may only be accepted by the person to whom it is made; **and**
 - (b) is made to a person who is likely to be interested in the offer, having regard to:
 - (i) Previous contact between the person making the offer and that person; **or**
 - (ii) Some professional or other connection between the person making the offer and the offeree; **or**
 - (iii) Statements or actions by that person that indicate they are interested in offers of that kind
- Importantly, the **advertising or publicity (whether direct or indirect) of offers covered by this exception is expressly prohibited (s734(1))**
- **HOWEVER**, in counting whether the \$2m ceiling is reached in **subsection (1)**, **disregard** amounts raised from issues and sales that (**s708(5)**):
 - (a) Do not need disclosure documents under **Ch 6D** (i.e. to existing shareholders/employees/CSF offers); **or**
 - (b) Are not received in Australia; **or**
 - (c) Are made under a disclosure document

Exception 2: Sophisticated investor exception PART 1: **s708(8)-(9C)**

- Offers of securities do not need disclosure if (**s708(8)**):
 - (a) the minimum amount payable for the securities is **at least \$500k**; or
 - (b) where securities are made to an **existing shareholder** with shares of the **same class**, the amount payable for the **new shares + the old shares** combined is **at least \$500k**; or
 - (c) if it appears from a certificate given by a qualified accountant no more than 6 months before the offer is made that the person to whom the offer is made:
 - (i) has **net assets of at least \$2.5 million**; or
 - (ii) has **gross income of at least \$250,000** for each of the last two financial years; or
 - (d) the offer is made to a **company or trust** controlled by a person who meets the requirements of **sub-s (c)(i) or (c)(ii)**

Exception 3: Sophisticated investor exception PART 2: s708(10)

- Offers of securities do not need disclosure if (**s708(10)**):
 - (a) the offer is made through a **financial services licensee**; and
 - (b) the licensee is satisfied on reasonable grounds that **the person to whom the offer is made has previous experience** in investing in securities that allows them to assess:
 - (i) the merits of the offer; and
 - (ii) the value of the securities; and
 - (iii) the risks involved in accepting the offer; and
 - (iv) their own information needs; and
 - (v) the adequacy of the information given by the person making the offer; and
 - (c) the licensee gives the person before, or at the time when, the offer is made a written statement of the licensee's reasons for being satisfied as to those matters; and
 - (d) the person to whom the offer is made signs a written acknowledgment before, or at the time when, the offer is made that the licensee has not given the person a disclosure document

Exception 4: Professional investor exception: s708(11)

- Offers of securities do not need disclosure if the offer is made to (**s708(11)**):
 - (a) a **professional investor**; or
 - (b) a person who has or controls **gross assets of at least \$10 million** (including any assets held by an associate or under a trust that the person manages)
- A **professional investor** is exhaustively defined and includes: (**s9**)
 - (a) a 'financial services licensee';
 - (b) (i) a superannuation fund, or (ii) an approved deposit fund, or (iii) a pooled superannuation trust, or (iv) a public sector superannuation scheme;
 - (c) bodies registered under the Financial Corporations Act 1974;
 - (d) trustees of (i) a superannuation fund, or (ii) an approved deposit fund, or (iii) a pooled superannuation trust, or (iv) a public sector superannuation scheme, **AND** the trust or scheme has net assets of at least \$10 million;

- (f) listed entities, or a related body corporate of a listed entity;
- (g) exempt public authorities
- (h) body corporates, or an unincorporated body, that (i) carries on a business of investment in financial products, interests in land or other investments; **and** (ii) for those purposes, invests funds received (directly or indirectly) following an offer or invitation to the public, the terms of which provided for the funds subscribed to be invested for those purposes; **OR**
- (i) foreign entities that, if established or incorporated in Australia, would be covered by one of the preceding paragraphs
- Note: This will be relevant when dealing with ESVCLP or VCLP investments. Both vehicles have a **minimum** committed capital of \$10m, and as such fall within the definition of 'professional investor'
 - Therefore, no disclosure is required when raising capital to one of these vehicles

Exception 5: Associated persons exception: s708(12)

- Offers of securities do not need disclosure if it is made to (s708(12)):
 - (a) a **senior manager** of the company or a related body or their spouse, parent, child, brother or sister; **or**
 - (b) a body corporate controlled by a person referred to in paragraph (a)
- '**Senior manager**' is a person other than a director or secretary who (i) makes or participates in making decisions that affect the whole or a substantial part of the business of the corporation, or (ii) who has the capacity to affect significantly the corporation's financial standing (s9)

Exception 6: For no consideration: s708(15-16)

- Offers of **securities** do not need disclosure if no consideration is to be provided for the issue or transfer of the securities (s708(15))
- Offers of **options** do not need disclosure if (a) no consideration is to be provided for the issue or transfer of the options, **and** (b) no consideration is to be provided for the underlying securities on the exercise of the option (s708(16))