Capital raising

Legislation referred to in this question is CA unless otherwise specified.

Chapter 6D applies to both offers and invitations.

Proprietary company

[Company] is a proprietary company because it (s 45A)

- is registered.
- is limited by shares or unlimited with share capital (s 112(1));
- and has no more than 50 non-employee shareholders (excl. CSF shareholders: s 113(2)(c)) (s 113).
    - [Employee shareholder] is both a shareholder and an employee of [company], or was an employee when they became a shareholder (s 113(2)(b)).
    - Joint holders of a particular parcel of shares are counted as one person (s 113(2)(a)).

<u>Option 1: Small proprietary company</u>

[Small proprietary company] is a small proprietary company for a financial year as it meets at least two criteria outlined in s 45A(2):

- Consolidated revenue, including controlled entities, is below $25 million for the financial year.
- The value of consolidated gross assets, including controlled entities, at year-end is less than $12.5 million.
- [Small proprietary company] and its controlled entities have fewer than 50 employees at year-end.

<u>Option 2: Large proprietary company</u>

[Large proprietary company] is a large proprietary company for a financial year as it meets at least two criteria outlined in s 45A(3):

- Consolidated revenue, including controlled entities, is $25 million or more for the financial year.
- The value of consolidated gross assets, including controlled entities, at year-end is $12.5 million or more.
- [Large proprietary company], including controlled entities, have 50 employees or more at year-end.

Capital raising

Because proprietary companies are not permitted to engage in any activity that would require disclosure under Ch 6D (s 113), their ability to raise funds through the offer of securities is limited to certain exceptions.

- Offering its shares to existing shareholders or employees (ss 45A, 113(3)).
- Engaging in a CSF offer (ss 45A, 113(3)).

- Offers falling within the exceptions outlined in s 708 (s 706) (see below).

Option 1: Small scale offerings

Red flag: friends, family and angel investors

The personal offer of shares to [offeree] does not require disclosure because it results in no more than 20 new investors and less than $2m being raised in any 12-month period (s 708(1)-(7)).

- Advertising or publicity of offers is prohibited.

Option 2: Sophisticated investors – financial status or income of the investor

The offer of shares to [sophisticated investor] does not require disclosure because (s 708(8)–(9C)):

- The minimum amount payable is at least $500,000; or
- A qualified accountant certifies that [sophisticated investor] has either net asset of at least $2.5m or a gross income of at least $250,000 for each of the last two financial years.

Option 2: Sophisticated investors – investment experience

The offer of shares to [sophisticated investor] does not require disclosure under s 708(10) as it is made through a financial services licensee, and the licensee is reasonably satisfied that [offeree] has previous experience in investing in securities, enabling them to assess:

- The merits of the offer.
- The value of the securities.
- The risks associated with accepting the offer.
- Their own information requirements.
- The sufficiency of the information provided by [offeror].

Option 3: Professional investors

The offer of shares to [offeree] does not require disclosure as [offeree] is classified as a 'professional investor' or an [individual / entity] that controls gross assets of at least $10 million (s 708(11)).

A professional investor is defined in s 9 CA as:

- a financial services licensee
- a body regulated by APRA or registered under the Financial Corporations Act
- the trustee of a superannuation fund, ADF, PST or public sector superannuation scheme (provided the fund, trust or scheme has net assets of at least $10m)
- a person who controls at least $10m
- a listed entity or related body corporate of a listed entity

- an exempt public authority a body corporate or unincorporated body that carries on a business of investment in financial products, interests in land or other investments and 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
- a foreign entity that, if established or incorporated in Australia, would be covered by one of the preceding paragraphs

Option 4: Associated persons

The offer of shares to [offeree] does not require disclosure because it is made to: (s 708(12))

- a senior manager of [company / related body];
- their spouse, parent, child, brother or sister; or
- a body controlled by such persons

Option 5: Issues or sales for no consideration

An offer of securities (excluding options) does not require disclosure because no consideration was provided for the issue or transfer of the securities (s 708-15).

Public company

[Company] is a proprietary company because it is not a proprietary company as per s 45A(1) (s 9).

Capital raising

Subject to certain exceptions (see above), an ‘offer of securities for issue’ requires disclosure to investors under Ch 6D (s 706).

To meet these disclosure requirements, [public company] must issue the appropriate disclosure documents and lodge these with ASIC (ss 705, 709-718, 727).

- Prospectus
- Offer information statement
- Profile statement

ASX company

To be listed, [company] must be a public company and adhere to the ASX’s listing rules.

- Having at least 300 non-affiliated investors, each with holdings valued at a minimum of $2,000.

- * Generating at least $1m in aggregated profit from continuing operations over the past three years and $500,000 in consolidated profit from continuing operations over the last year OR
- * Possessing net assets of at least $4m or a market capitalisation of at least $15m.

Listed companies are obligated to report both semi-annually and annually, and must comply with continuous disclosure requirements.

Capital raising

[ASX-listed company] must raise capital through initial public offerings (IPOs) when they first list on the ASX. Subsequent capital can be raised through:

- Placements
- Share purchase plans
- Right issues

Crowd sourced equity funding

Legislation referred to in this question is CA unless otherwise specified.

CSF offer

Eligible CSF company – s 738H

[CSF company] is as an eligible CSF company at the time of the offer because (s 738H(1)):

- It is a public company limited by shares / a proprietary company with at least 2 directors, meeting all other prescribed requirements.
- Its principal place of business is in Australia.
- The majority of its directors usually reside in Australia.
- It satisfies the 'assets and turnover test' (s 738H(2)).
    - [CSF company], together with related parties, has consolidated gross assets and annual revenue both below $25 million.
- Neither [CSF company] nor any related party is a 'listed corporation'.
- Neither [CSF company] nor any related party primarily invests in securities or interests in other entities or schemes.

Eligible CSF offer – s 738G

[CSF company] made a CSF offer as it is eligible to be made under Part 6D.3A (see s 738G(1)) and is expressed to be made this Part (s 738B). In particular (s 738G(1)),

- It is made by [CSF company] for issuing its own securities.
- [CSF company] is an 'eligible CSF company' at the time of the offer (see above).
- The securities offered is belong to a specified class (ie fully-paid ordinary shares).
- It complies with the 'issuer cap' (s 738G(2).
    - It is because the total of
        - the maximum amount sought to be raised by the new offer,
        - any amounts raised in the preceding 12 months pursuant to CSF offers, and
        - any amounts raised in the preceding 12 months that did not require disclosure under s 708(1) for small-scale investors or s 708(10) for sophisticated investors
    - do not exceed $5 million
- [CSF company] or its related party does not intend to invest any raised funds in securities or interests of other entities or schemes.

- Any other requirements in the regulations must be met (s 738G(1)).

ESS

Legislation referred to in this question is ITAA97 unless otherwise specified.

Application of div 83A ITAA97

<u>Option 1: employee acquired ESS</u>

New div 83A applies because [employee] acquired an ESS interest (ie [the shares / the right to acquire shares]) under an ESS (s 83A-20(1)):

- ESS interest includes a stapled interest that includes a share (s 83A-335) / ESS interest includes a right to acquire stapled interests that include such shares (s 83A-335).
- [Employee]'s ESS interest was acquired on or after 1/7/2015 and is provided in relation to [employee]'s employment (83A-10(2)).

<u>Option 2: associate acquired ESS</u>

New div 83A applies to [the shares / the right to acquire shares] acquired by [employee's associate] (s 83A-20(1)) because

- ESS interest includes a stapled interest that includes a share (s 83A-335) / ESS interest includes a right to acquire stapled interests that include such shares (s 83A-335).
- [employee's associate] is an associate of [employee] as per s 318 ITAA36 (s 995-1(1)), and ESS interest acquired by associate of [employee] is treated as though the ESS interest was acquired by [employee] (83A-10(2)).
- The ESS interest was acquired on or after 1/7/2015 and is provided in relation to [employee]'s employment (83A-10(2)).

<u>Option 3: Interests in shares held by a trust</u>

[Employee] acquired an interest in a trust with assets including shares or rights, and under s 83A-320(2), [employee] is considered to hold a beneficial interest in that particular number of shares or rights (see s 130-85), thereby meeting the definition of ESS interest under s 83A-10. Moreover, this ESS interest was acquired on or after 1/7/2015 and is provided in relation to [employee]'s employment (83A-10(2)). As a result, the new div 83A applies.

Upfront taxation (sub-div 83A-B) OR deferred taxation (sub-div 83A-C)?

Upfront taxation automatically applies (s 83A-25(1)) unless the requirements for deferred taxation in s 83A-105 are satisfied.

Option 1: ESS interest is shares

For deferred taxation applies, the ‘broad availability of schemes’ condition can be satisfied (s 83A-105(2)) and pass either the ‘real risk of forfeiture’ test under s 83A-105(3)(a) or ‘salary sacrifice arrangement’ test under s 83A-105(4) (s 83A-105(1)(c)).

Broad availability of scheme

At the time of acquisition, at least 75% of Australian resident permanent employees who have completed three years of service, including non-continuous service, must be, or have previously been, entitled to acquire ESS interests under the same scheme or another ESS with [employer] or its holding company (s 83A-105(2)).

- *Interpretative Decision ID 2003/24* - the Commissioner held that the 75% permanent employees condition from former s 139CD(5) ITAA36 is met when an employer has no permanent employees with three years or more of employment.

Real risk of forfeiture

At the time of acquisition, there is a ‘real risk that, under the conditions of the ESS, [employee] will forfeit or lose the ESS interest other than by disposing of it’ (s 83A-105(3)(a)). It is because [x].

- Rules that impose minimum terms of employment, or meaningful performance hurdles, are considered to involve a real risk of forfeiture. A rule that only restricts [employee] from disposing of the right or the share for a qualifying period is not sufficient.

(a) At real risk of forfeiture

- Shares will vest at the end of three years if he is still employed. If the employment ceases inside three years for reasons beyond his control, such as sickness or redundancy, the shares will still vest under a “good leaver” rule.
- Each annual allotment of shares will be forfeited if Felix leaves the network within three years of the date of allotment, to work for another media organisatipaon.
    - Felix is a skilled employee who would be unlikely to find comparable employment outside the media.

(b) NOT at real risk of forfeiture

- ceases employment within 3 months + cannot sell the shares within five years

  - The Plan’s rules are contrived to obtain a long deferral of tax with a limited risk of forfeiture.
- shares will vest at the end of three years, unless he is dismissed before that time for reason of fraud or gross misconduct.
  - Any act of the employee that caused the dismissal would be his own fault and a reasonable person would disregard that risk as being a ‘mere possibility’.

Salary sacrifice arrangement

This test is satisfied because (s 83A-105(4)):

- The shares were acquired in return for a reduction in [employee]’s salary or wages / as part of their remuneration package (s 83A-105(4)(a)).
- At the time of acquisition, the discount was equal to the market value of the ESS interest – [employee] received the shares for no consideration (s 83A-105(4)(b)(i)).
- Scheme rules expressly state that sub-div 83A-C applies to the scheme (s 83A-105(4)(b)(iii)).
- At the time of acquisition (s 83A-105(5)), the total market value of ESS interests acquired (ie $X) during the income year does not exceed $5,000 (s 83A-105(4)(c)).

S 83A-105(4)(b)(ii) is relevant when, at the time of acquisition, [employee] acquired shares by way of salary sacrifice and also granted a right to acquire additional shares.

<u>Option 2: ESS interest is a right to acquire shares</u>

For deferred taxation applies, the ESS must pass either a ‘real risk of forfeiture’ test under s 83A-105(3)(b) <u>or</u> a ‘genuine restriction on disposal’ test under s 83A-105(6).

Real risk of forfeiture

At the time of acquisition, there is a real risk that, under the conditions of the ESS, [employee] will forfeit or lose either (s 83A-105(3)(b)):

- The right itself, other than by disposing of the right, exercising the right, or letting the right lapse; or
- (If the right is exercised) the share acquired after exercising the right, other than by disposing of it.

It is because [x].

Genuine restriction on disposal

The ESS must genuinely restrict the immediate disposal of the right; and the governing rules of the scheme must state that subdiv 83A-C applies to the scheme (s 83A-105(6)).

Example

- ESS rule that contractually prevents disposal of the share

- a law that makes disposal of the share a criminal offence, such as a law against insider trading
- an internal share trading policy of employer, provided that there is a meaningful penalty for breaching the company policy that is strictly enforced.

Option 3: other conditions (apply to both)

The start-up concession in s 83A-33 does not reduce [employee]'s assessable income for the interest (s 83A-105(1)(ab)).

Moreover, ss 83A-45(1), (2), (3) and (6) conditions are satisfied because

- [Employee] was employed by [issuing company / its subsidiaries] when the ESS interest was acquired.
- The ESS shares only relate to the issue of ordinary shares.
- The predominant business of [the company] is not the acquisition, sale or holding of shares, securities or other investments.
- Immediately after acquiring the ESS interest, [employee] did not hold a beneficial interest in more than 10% of the shares in [the company] or control more than 10% of the voting rights in [the company] (see s 83A-45(7)).

Application of deferred taxation

As a result, [employee]'s tax will be deferred until the 'ESS deferred taxing point'. The market value of the ESS interest at the ESS deferred taxing point *less* the 'cost base' of the ESS interest (83A-110(1)).

Market value of the ESS interest at the deferred taxing point

Option 1: ESS interest is shares

The deferred taxing point is the earliest of the following times (s 83A-115(4)):

- when there is no real risk under the ESS of forfeiture or loss of the shares and any genuine restrictions preventing their disposal no longer apply; or
- 15 years after the shares were acquired (ie X)

Hence, the deferred taxing point will be X.

However, if [employee] disposes of an ESS interest within 30 days of the deferred taxing point, the deferred taxing point is taken to be the date of disposal (s 83A-115(3)).

Option 2: ESS interest is a right to acquire shares

The deferred taxing point is the earliest of the following times (s 83A-120(4)):

- (if the rights have not been exercised) when there is no real risk under the ESS of forfeiture or loss of the rights and any genuine restrictions preventing their disposal no longer apply;
- 15 years after the rights were acquired; or
- (if the rights have been exercised) when there is no real risk under the ESS of forfeiture or loss of the underlying shares and any genuine restrictions preventing the disposal of the shares no longer apply

Hence, the deferred taxing point will be X.

However, if [employee] disposes of an ESS interest within 30 days of the deferred taxing point, the deferred taxing point is taken to be the date of disposal (s 83A-120(3)).

Cost base of the ESS interest

The cost base is determined according to the CGT rules (sub-div 110-A). The cost base of a CGT asset has five elements (s 110-25(1)):

First element – purchase price (s 110-25(2))

The first element is the total of the money [employee] pays, or is required to pay, and the market value of any property [employee] gives, or is required to give, in respect of acquiring the ESS interest (s 110-25(2)).
The amount actually paid for the share forms the first element of the cost base (s 110-25(2)).

Second element – incidental cost (s 110-25(3))

The second element is the incidental costs incurred by [taxpayer] (s 110-25(3)).

Therefore, [employee] will be assessed on $X ($Y - $Z) in the 2023/24 income year.

Only if relevant: source of income

Option 1: resident employee

[Resident employee] would be assessed on income from all sources, whether in or out of Australia (s 6-10(4)).

Option 2: foreign employee

To the extent that a discount is attributable to employment outside Australia, it is treated as foreign source income (s 83A-110(2)). [Foreign employee] would be assessable on the portion of the gain that is deemed to have an Australian source (s 6-10(5)).

CGT

Sub-div 130-D deals with the CGT implications of ESS interests acquired under ESS. [Employee] is generally exempt from CGT until they have been taxed under div 83A (s 130-80(1)).