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Re: Consultation for Tax Incentives for Early Stage Investors

It is a pleasure to provide this consultation as part of the Policy Discussion Paper (PDP) regarding tax incentives for early stage investors. As arguably the wealthiest person of all time, John D Rockefeller, said: "The hardest part all through my business career was to obtain enough capital to do all the business I wanted to do and should do given the necessary amount of money." This is particularly true in Australia and I applaud this initiative and welcome the tax relief incentives becoming legislation at the earliest.

To provide some background, I have experience with the Seed Enterprise Investment Scheme (SEES) and Enterprise Investment Scheme (EIS) in the UK where I have achieved advance assurance for six companies as SEIS and EIS qualifying and funded two companies under SEIS and EIS. The UK SEIS and EIS programs are extremely efficient structures to attract start up and growth capital for companies and their investors.

To provide an example, Rimbal is a financial technology company that identifies, licenses and builds proven investment platforms and online business models that it transfers to, and operates in, Australia and New Zealand. Due to the potential for 'seed' fundraising in Australia being limited, through Rimbal Ltd in the UK we raised funds under SEIS/EIS to expand our business in Australia. We will seek a strategic Australian investor(s) in due course, however, it was necessarily to raise funds in the UK in-order to take our business forward.

On this note, I refer you to an Australian Times (UK) article *'Australia's tech investment black hole: why we are missing out to the UK'* that we contributed to: http://www.australiantimes.co.uk/australias-tech-investment-black-hole-why-are-we-missing-out-to-the-uk/

General Feedback on the Tax Incentive

It has been stated that the new tax incentive will provide investors with:

- *A 20 per cent non-refundable tax offset based on the amount invested either directly in the qualifying start-up or indirectly through a fund, up to an offset cap per investor of $200,000 per year.*

In the UK, the SEIS program allows qualifying companies to raise up to £150,000 and eligible investors to reduce their liability to income tax at the rate of 50% on the amount invested with the maximum investment per investor of £100,000. The EIS program program allows qualifying companies to raise up to £5,000,000 per annum and eligible investor to reduce their liability to income tax at the rate of 30% on the amount invested with the maximum investment per investor of £500,000.

It is known amongst those familiar with the scheme that the SEIS program is limited at only allowing companies to raise £150,000 and would be more helpful for companies if it was £250,000. However, recent policy announcements enable a company to raise both SEIS and EIS funds simultaneously which provide flexibility to raise a larger first investment tranche to execute the business plan (i.e. 50% relief on first £150,000 and 30% relief above £150,000 up to £5,000,000).

In Australia, I would propose that a similar two-tiered approach would be beneficial and that the tax relief should mimic the UK SEIS and EIS magnitudes of 30% to 50% in-order to maximise the incentive for investment into innovative companies, ideas and entrepreneurs.

An example, a qualifying Innovation Company could raise up to AU $500,000 with eligible investors able to reduce their liability to income tax at the rate of 50% on the amount invested with the maximum investment per investor of AU $200,000. And a qualifying Innovation Company could raise AU $5,000,000 with eligible investors able to reduce their liability to income tax at the rate of 30% on the amount invested with the maximum investment per investor of AU $1,000,000.

It has been stated that the new tax incentive will provide investors with:

- *The non-refundable tax offset will be available once the funds are committed and subscribed.*

Based on my experience in the UK, it will be very important to understand the mechanism for this to be achieved by the company to enable the investor to realise the tax offset. In the UK, this is a burden on the company, a manual 'paper' process and a limiting and critical path issue in the investment process. In Australia, if this could be digitalised and streamlined it would be advantageous.

It has been stated that the new tax incentive will enable either a direct or indirect investment with:

- *A capital gains tax (CGT) exemption on those investments, provided they are held in the qualifying company for at least three years.*

As is elaborated on below, it will be important to understand what occurs if a company has an exit through a trade-sale, listing or other mechanism in under three years. There should be no incentive for the company/investor to lose the CGT relief based on the company being successful and achieving an early exit particularly a listing to raise growth capital.

General Feedback based on the Policy Discussion Paper (PDP)

Point 1	
PDP	*The tax offset will be available to both residents and non-residents.*
Feedback	This is a positive initiative that I strongly support.

Point 2	
PDP	*Where shares are held for more than 10 years, any incremental gain in value after 10 years will be subject to CGT and deemed to be on capital account.*
Feedback	Why do this? Firstly, this will not (likely) influence the investment decision into an Innovation Company. And the revenue derived from this CGT tax after 10 years cannot possibly be modelled accurately (due to company failure, etc.). The mechanism basically provides the Government an option to tax 'winners'… that is companies and investors that have created significant shareholder value and are a minimum of 10 years old. I would propose the tax contribution by this type of company will be substantial already and the incremental CGT revenues negligible. Therefore, I would propose that there is not capital gains tax on any Innovation Company capital gain.

Point 3	
PDP	*The final access point will be through determination by the ATO before the investment is made into an innovation company, at the instigation of the company or a potential investor.*
Feedback	The UK has an Advance Assurance process enabling the company and investor to have 'advance assurance' from HMRC that the company is a qualifying company under SEIS/EIS. There are appropriate disclaimers from HMRC such as 'based on evidence provided by the Company' and the company (and investor) will only know for certain when the company makes an application to receive the SEIS/EIS certificates for investors. That is, you could have 'advance assurance' from HMRC and when you make the application be denied (though this would be rare). Having 'advance assurance' is a 'must have' for any company and a requirement for most crowdfunding platforms (such as Seedrs.com). However, it is not a requirement. And is not necessarily a 'deal breaker' for some investors as the company (and investor) will only have 100% assurance that HMRC deems the company as SEIS/EIS qualifying when they apply for the SEIS/EIS certificates. Conclusion: It would be an absolute necessity for the ATO to have a streamlined process for providing 'advance assurance' or otherwise approving the Innovation Company as qualifying for the relief. Therefore, it will be very important to understand the mechanism and structure of how the investor (and company) will claim the tax relief. In the UK, 'advance assurance' can take 4 to 8 weeks (depending on how busy HMRC are) and the processing of receiving the SEIS/EIS certificates can take 4 to 8 weeks. NOTE: In the UK every company must manually fill in the SEIS/EIS claim forms and then send them to their investors. This is a tedious, time consuming and unnecessarily process and should be streamlined and digitalised in Australia.

Point 4	
PDP	*Re: Method 1 – Principles-based* *The definition would also require the innovation company to exhibit high growth potential through a management team being able to successfully scale the business as it grows and maintain competitive advantages over incumbents or new competitors.*
Feedback	It is unreasonable that an Innovation Company must be able to 'exhibit high growth potential'. Not many companies across the global economic spectrum are capable of high growth and the tax relief should not discount companies that may not have high-growth potential, yet can create positive economic and social benefits for the community. An example may be an Innovation Company that solves a particular need in a smaller rural community that is supported from an investor perspective by the community. It is unreasonable for an Innovation Company being required to have 'a management team being able to successfully scale the business as it grows and maintain competitive advantages over incumbents or new competitors' as it is subjective. Is this based on a management teams' track-record, experience, credentials, etc…? I would discourage anything requiring Government making this judgment call.

Point 5	
PDP	*Re: Method 2 – Gateways and Safe Harbours* *Companies that have, within the last three years, developed, acquired or licensed an idea that has been filed as a patent in multiple jurisdictions.*
Feedback	In-relation to licencing a technology for application in Australia, it is unreasonable to restrict an Innovation Company based on a licence to a patent. Many technologies (particularly digital technologies) which can be licenced are based on proprietary intellectual property that is not protected by a patent, however, would provide a fantastic basis for a business through an Innovation Company in Australia under a licence arrangement.

Point 6	
PDP	*Re: Method 3 – Exclusions*
Feedback	It is important to note that in the UK some of the excluded activities are based on the fact that the UK has other tax relief incentives for that activity and is trying to avoid 'double dipping'. A good example is point 7: 'Holding, managing or occupying woodlands, any other forestry activities or timber production'. In the UK there are numerous and substantial tax relief incentives for investment in UK woodlands. Therefore, this is an excluded SEIS/EIS activity to avoid a double tax incentive. However, there is precedent for HMRC to provide SEIS/EIS tax relief for UK forestry companies who are developing projects (or providing forestry services) outside of the UK (i.e where there are no tax incentives for UK investors). Therefore, this should be considered in Australia so that activities are not excluded that could utilise the tax relief incentive to benefit the economy. Forestry is a good example. I have direct experience in the forestry industry and there are many innovative forestry and sustainable land management companies that would benefit by being classified as an Innovation Company and able to develop their niche product or services businesses in Australia (where the industry is still struggling from the boarder Managed Investment Scheme tax incentive fallout).

Point 7	
PDP	*Re: Method 3 – Exclusions* *However, the intention is not to exclude the high-growth potential industries like financial technology.*
Feedback	It is important to note that financial technology is not excluded in the UK. Platform operators and even fund management companies can be SEIS/EIS qualifying if they do not deal in the securities themselves and simply provide a management and operational function.

Point 8	
PDP	*An eligible innovation company must not be an entity listed on any stock exchange.*
Feedback	In the UK, a company may be SEIS/EIS qualifying and quoted on an exchange market or listed on an exchange market such as the London Stock Exchange AIM market. I do not see why this should be a restriction in Australia for secondary markets such as National Stock Exchange or for companies that achieve rapid growth and then undertake a listing on the ASX. This is particularly relevant in Australia where the venture capital and start-up investor market is less developed (i.e. then the UK) often resulting in companies needing to seek growth capital through public markets such as the ASX. Therefore, I strongly feel that being listed should not harm a company's qualification as an Innovation Company and restrictions could be put in-place to maintain the integrity of the scheme (such as the qualification status not being lost by a start-up Innovation Company going public).

General Comments

Point 9: Company Structure and Ownership	
Comment	In the UK, an SEIS/EIS qualifying company must be owned by an individual and not a company. This is restrictive for company founders/owners/Directors who may wish to put their equity holding into a trust or company. The basis for this as the qualifying company must not be a subsidiary of another company. It would be highly advantageous if an Innovation Company could be owned by a company or trust with perhaps the restriction that the owning company or trust must be owned and/or controlled by the founding Directors (with restrictions on the owning/controlling company or trust having access to the funds raised into the Innovation Company).

PDP Questions: Australian Innovation Company

4.1 Are there any additional principles that should be included in defining an innovation company?

In-relation to the principles, it will be important to understand what specific number or configuration of the criteria that translate to the company being eligible as an Innovation Company and how the classification as an Innovation Company is formalised before determining what other principles should be considered. For example, if Method One or Method Two is used by the company, (i.e. not Method Three through an ATO determination), can the ATO refuse to provide the tax offset? There needs to be certainty for companies and investors. In the UK, even with Advance Assurance an SEIS/EIS qualifying company only has certainty when it receives the SEIS/EIS forms from HMRC.

4.2 What gateway criteria would best define an eligible innovation company?

The gateway criteria should be non-subjective to provide clarity for companies and investors that the company qualifies as an 'Innovation Company' without the requirement for input from the ATO. An example of criteria to achieve this would be that the company structure (company type, jurisdiction, shareholders, share capital structure, etc.) satisfies ATO requirements and that the company undertakes a qualifying activity (i.e. that is not an excluded activity).

4.3 Do these criteria meet the objective of attracting investment in innovation companies, without unnecessary regulatory burdens?

It is not a regulatory burden if it is voluntary option for the company. However, what needs to be insured is that the process to get approval as an Innovation Company, manage the process as a company and provide the tax relief (documentation/acknowledgement) to the investors is streamlined. In the UK (as mentioned above), this can be burdensome. Specifically, having to wait 4 to 8 weeks to get feedback from HMRC and the process of applying for, and then sending to investors, the SEIS and EIS forms for investors to claim their tax relief.

4.4 What integrity risks are associated with each of these criteria? How might these risks be mitigated? For example, combining multiple tests together could mitigate risks.

An integrity risk is that the company ceases to maintain its operations and structure to satisfy the qualifications as an 'Innovation Company'. This can be managed by having the investor liable to lose the tax relief if the company ceases to comply with the conditions for a period of time (such as three years).

4.5 Are investors open to a process that involves lodging a self-assessment declaration prior to making investments, in order to assist with assessing take up and eligibility?

Investors should be able to self-certify before, however, in line with the process of making an investment. In the UK this is common. It is a simple self-assessment and declaration and should not be restrictive on investment.

4.6 In relation to a gateway requirement that is based on approved accelerator programs, which types of organisations should be included and what qualifying criteria should be specified?

This is subjective. There are examples such as the UK Tier-1 Entrepreneur Visa where you can get acknowledgement if you have been into an accelerator program. An issue, however, is that is disadvantages companies/individuals who take alternative (and potentially more sophisticated) funding routes. For example, Rimbal Ltd engaged a financial advisor regulated by the Financial Conduct Authority (FCA) who raised funds from its investor clients. Therefore, in addition to accelerator programs, it should also include companies that attract investment from angel investment groups, venture capital firms and/or engage financial advisors (or brokers) or other professional advisors to assist in growing and funding the company. That is, the validation should not just be limited to an accelerator program, it should be broader to include other financial advisors such as those that are regulated by ASIC or otherwise provide services on a consultancy basis.

4.7 Are there any other investment activities that should be excluded?

It is important to consider what other tax relief incentives exist for the activity and to not create adverse market forces other than the intended tax incentive for early stage investors. For example, in the UK a company that is not SEIS/EIS qualifying or is otherwise looking to raise up to £5,000,000 is greatly disadvantaged as investors have a 50% to 30% incentive on the upside and downside to invest into an SEIS/EIS qualifying company instead. This has led to in the UK, and will lead to in Australia, early-stage companies that do not qualify for the tax relief incentive having less access to early-stage investment capital to fund growth then prior to the tax relief program. This should be considered in Australia to not adversely affect industries and to ensure that certain activities are not excluded.

4.8 Is it appropriate for innovation companies to be restricted to companies that are Australian residents for tax purposes?

Yes, however, this depends on what restrictions are placed on the share ownership structure for qualifying companies. For example, if a founder could own their shareholding in an Innovation Company in a company or trust, then having their shareholding in an offshore company may be advantageous.

Regarding investors, I strongly support the position that residents and non-residents are able to claim tax relief for investment in Innovation Companies.

<u>PDP Questions: Direct Investment into an Innovation Company</u>

5.1 Are there any specific requirements that should be included within the sophisticated investor test to ensure that innovation companies are benefiting from both financial and technical/commercial support?

No. The sophisticated investor test should freely enable qualifying investors to invest in Innovation Companies. The benefit of having investors who can provide financial, technical and commercial support is at the discretion of the company and will be subject to market forces.

5.2 Other than the sophisticated investor test contained in the Corporations Act 2001, are there alternative tests that can achieve these same objectives?

Yes, the definition of sophisticated investor should be broadened to cover additional criteria options (similar to the UK) such as:

(a) Being a member of a network or syndicate of business angels for at least the last six months prior; or
(b) Making more than one investment in an unlisted company in the two years prior; or
(c) Working or having worked in the two years' prior in a professional capacity in the private equity sector, venture capital industry, as an authorized representative of an Australian Financial Services Licence or in the provision of finance for small and medium enterprises; or
(d) Being, or have been in the two years' prior, a Director of a company with an annual turnover of at least $1 million.

<u>Conclusion</u>

It is a pleasure to provide this consultation as part of the PDP regarding tax incentives for early stage investors. And I would welcome providing any additional input particularly in-relation to the 'Method 3 - Determination' criteria and administrative processes for engaging with the ATO (from a company and investor perspective) based on my experiences in the UK. Feel free to contact me to discuss further. I applaud this initiative and would welcome the tax relief incentives getting passed into legislation at the earliest.

Sincerely,

Angus MacNee
Managing Director
Rimbal Financial Pty Ltd

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