

## Fast Growing And Start Up Businesses – What Are You Missing Out On?

It's always difficult for Governments and regulators to keep pace with changing business models, funding approaches, and technology. But, recent reforms and a series of new initiatives seek to free up entrepreneurs from excessive regulation, inflexible tax regimes, and unintended outcomes.

Few entrepreneurs are aware of what incentives are available to them and risk limiting their options for growth. I take you through what's available and some of the tax implications of capital raising outside of the mainstream.

### Tax relief for business changing structures

It is common for a business to outgrow its business structure. Alternatively, changes in circumstances over time might mean that a business structure is no longer as effective as it could be. Small business entities can now rollover from one business structure to another without triggering adverse implications under the income tax system.

Under new rules that apply from 1 July 2016, if your business genuinely needs to move from one structure to another for commercial reasons, you can do this without triggering a tax bill if certain conditions are met. This new form of rollover relief can provide complete income tax relief when assets are transferred to any business structure (e.g., sole trader, partnership, company or trust) if the following key conditions are satisfied:

- The transaction is a genuine restructure of an ongoing business. So, the concessions can't be used for winding down or selling a business.
- Each of the parties to the transaction is a small business entity (revenue under \$2m, although this might be increased to \$10m) or is related to a small business entity in the year the transaction occurs. The turnover test is subject to some grouping rules.
- The business owners (the people who have ultimate economic ownership of the assets) and their share in those assets doesn't materially change.
- The asset being transferred is currently being used in a business carried on by the current owner or certain related parties.
- Both the original entity and the entity the business is being transferred into need to be Australian residents.
- The parties involved in the transaction must choose jointly to apply the rollover.
- None of the entities involved in the transaction are a superannuation fund or exempt entity.

## Incentives for angel investors

For innovative companies, it's often difficult to get funding before what they are developing is commercialised. Early stage innovation investment (often called 'angel investors'), in pre-commercialised developments is often very risky but when it works, the rewards can be great.

New tax laws offer incentives for investment in these early stage innovation companies (ESIC):

- Entities acquiring newly issued shares in an Australian early stage innovation company will receive a non-refundable tax offset of 20% of the value of the investment, subject to a maximum offset cap of \$200,000.
- Investors can also disregard any capital gains realised on the shares if they have been held for between one and ten years.

The incentives are designed to connect start-up companies with investors that have both the capital and business experience to help develop successful innovative companies, particularly at the pre-commercialisation phase - where a concept is in development but the company needs additional funds to commercialise.

The amendments are designed to apply to a broad range of potential investors who are either investing directly or through a company, trust or partnership. As investments in innovation companies are often high risk, the amendments limit the risk exposure of investors to \$50,000 per year. The rules are more relaxed for sophisticated investors.

In general, an ESIC qualifies if it is:

- At an early stage of its development; and
- Developing new or significantly improved innovations with the purpose of commercialisation to generate an economic return.

The initiatives also extend to early stage venture capital partnerships offering:

- A limited partner in an early stage venture capital limited partnership (ESVCLP) is entitled to a non-refundable, carry-forward tax offset which is equal to up to 10% of contributions made by the partner to the ESVCLP during the year. The amount of the tax offset may be reduced if the amounts contributed by the partners are not used by the ESVCLP in certain ways.
- The maximum committed capital of an ESVCLP is increased from \$100m to \$200m.
- If an ESVCLP does not dispose of an investment within a certain time period, the ESVCLP will only be entitled to a partial CGT exemption.

Employee share schemes to help fast growth companies attract talent

Employee share schemes, if structured correctly, can be an effective way of incentivising staff by linking personal reward to company growth. They are also very useful for fast growth start-up and innovative companies that want to attract top talent but lack the capital to compete on salary alone.

Recent changes to how Employee Share Schemes (ESS) are taxed make the schemes more attractive with a common sense approach to how they are taxed.

Under an ESS, employers issue shares (an ownership stake) and/or options (a right to acquire shares at a later date) to their employees at a discount to the market value of the shares or rights. In general, when an employee receives shares or rights under an ESS they are taxed on the discount they have received. Under the new rules, it is now easier to defer the taxing point until it's clear that the employee will actually derive an economic benefit from the shares or options they have received (this is possible under the old rules but in a narrower range of situations).

In addition, special rules exist for start-ups that allow relatively small discounts received by employees in relation to shares or rights not to be taxed at all under the ESS rules if the relevant conditions are met.

## Research and development tax incentive

The research and development (R&D) tax incentive has been around for a while in various forms but it's worth considering. The Government provides this tax offset to encourage companies to conduct R&D activities that benefit Australia. The current tax-offset rates that apply to qualifying companies are:

- A 43.5% refundable tax offset for companies with an aggregated turnover of less than \$20 million (unless they are controlled by tax exempt entities); and
- A 38.5% non-refundable tax offset for all other companies.

The rate of the R&D tax offset is reduced to the company tax rate if the company's notional R&D deductions exceed \$100 million for an income year.

## Imminent changes to crowdfunding

Crowdfunding uses internet based platforms and other forms of social media to raise funds for projects or business ventures. Generally, the party trying to raise the funds (the promoter) will engage an intermediary (the platform) to collect funds from contributors. There are different ways this can be done and how the crowdfunding is raised will determine the tax treatment of any funds received:

- Donation-based - The contributor does not receive anything in return other than an acknowledgement
- Reward-based - The promoter provides something in return for the payment (e.g., goods, services, rights, discounts etc..)
- Equity-based - The contribution is made in return for shares in a company
- Debt-based - The contribution is made in the form of a loan with the promoter making interest and principal payments

A Bill that has just passed Parliament seeks to create a regulatory framework for crowdfunding. The popularity

*"I'm always impressed by the amount of innovation that is taking place in Queensland. But when I talk with business owners and innovators, I often hear one of two things – that they didn't know an incentive existed, or that they think the incentive is too difficult and time-consuming to obtain and therefore not worth applying for. The answer to both of these issues is to find the right advisors that can assist you to get the maximum benefit you are entitled to with the minimum of fuss. Any incentive programs from Government will have complexity and typically change on a regular basis – having the right assistance to navigate the detail is key."*



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of crowdfunding as an alternate to mainstream finance has increased dramatically and at present, the Government has no viable way of protecting investors or regulating how crowdfunding is raised. These new rules bring crowdfunding under the Corporations Act while attempting to avoid onerous regulatory commitments that will stifle the flow of funds. Despite simplified reporting obligations, the changes will invariably add a layer of complexity for promoters and platforms. The rules also restrict how much Mum and Dad investors (retail clients) can invest in a single company in any one year to \$10,000, and provide a cooling off period of 5 days. You can expect these changes to start coming into effect this year.

From a tax perspective, funds from crowdfunding are treated like any other form of income – the funds are likely to be taxable if:

- The crowdfunding relates to employment activities (e.g., raising money to fund a project that is linked to existing employment duties);
- The promoter enters into the arrangement with the intention of making a profit or gain and the project is operated in a business like way; or
- The funds are received in the ordinary course of a business.

If funds are received for a personal project where there is no intention of making a profit (e.g., the project relates to a hobby), these funds are generally not taxable for the promoter.

When funds are received under an equity based crowdfunding model the funds would generally form part of the share capital of the company that is undertaking the project. If so, the funds should not be included in the assessable income of the company. If payments are made by the company to contributors then these would generally be treated as either dividends (it may be possible to attach franking credits to the dividends) or a return of share capital.

Likewise, when funds are received under a debt based crowdfunding model the funds would not be assessable to the company as they would simply be treated as a loan. When payments are made by the promoter to contributors the interest component might be deductible in some circumstances.