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Corporate Finance

QUARTERLY INSIGHTS INTO KEY FINANCE MATTERS AFFECTING YOUR BUSINESS

ISSUE 14

ON CORPORATE FINANCE

$200M INNOVATION FUND:

‘IDEAS BOOM’ SPARKS HOPE FOR OZ ECONOMIC FUTURE

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INNOVATION STATEMENT – CAPITAL RAISING CONCESSIONS

As unveiled in the innovation speech by Prime Minister Malcolm Turnbull on 7 December 2015, the Federal Government proposes to legislate to provide small businesses and investors in innovative companies tax concessions and other benefits designed to spur economic growth. The innovation strategy for Australia involves 24 incentive measures costing a $1.1 billion over four years, including:

- a $200 million innovation fund will co-invest in businesses that develop technology from the CSIRO and Australian universities;
- early stage investors in start-up businesses will receive:
  – a 20 per cent non-refundable tax offset; and
  – a capital gains tax exemption;
- investors in new early stage venture capital partnerships will receive a 10 per cent non-refundable tax-offset;
- companies may be able to tax depreciate certain newly-acquired intellectual property at a faster rate than currently allowed; and
- the ability to access company tax losses will be improved.

The measures are to drive what has been termed the "Ideas Boom" for the economy.

The new arrangements will apply from the date of Royal Assent and are expected to commence from 1 July 2016. The success of the innovation strategy will lie in the detail of the measures (yet to be released) and the manner of implementation.

The Government will also review the existing research and development tax incentive program.

Tax incentives for investors

Capital gains tax concessions

Firstly, capital gains tax concessions will be provided to investors to encourage capital raising and investment demand. Investments in start-ups by individuals and vendors will be free of capital gains tax for ten years, should the investment be held for at least three years.

Tax offset of 20 per cent of investments

Secondly, a non-refundable tax offset (rebate) (rather than a tax deduction) of up to $200,000 per investor, per year, (based on a 20 per cent rebate on a maximum investment of $1 million in start-ups) is included in the plan.

The incentive will be available for investments in start-up companies that:

- undertake an eligible business (scope is yet to be determined);
- that were incorporated during the last three income years;
- aren't listed on any stock exchange; and
- have expenditure and income of less than $1 million and $200,000, respectively, in the previous income year.

Early Stage Venture Capital Limited Partnerships

Thirdly, a non-refundable tax-offset of 10 per cent of the amount invested will be available for new investments in Early Stage Venture Capital Limited Partnerships (ESVCLPs) (an existing statutorily defined innovation investment vehicle) to attract more investment into high potential start-ups.

The maximum fund size for new ESVCLPs will be increased from $100 million to $200 million and ESVCLPs will no longer need to divest an investee company when its value exceeds $250 million.

The ESVCLP programme is designed to stimulate the Australian early stage venture capital sector. A venture capital fund which is registered as an ESVCLP receives "flow-through" tax treatment thus investors (limited partners) are exempt from tax in the investment vehicle itself (i.e. the ESVCLP).

Managers of the ESVCLP are also entitled to claim their carried interest on the capital account rather than as revenue.

In order to be eligible, funds must have committed capital in the range of $10 million to $200 million, the upper bracket of which has been increased from $100 million as part of the government's innovation strategy. Individual investors (limited partners) are limited to contributing 30 per cent of the fund's committed capital. Furthermore, for an investment to be eligible, the Australian business must have less than $50 million in assets, not have a predominant activity in property development, land ownership, finance or construction and be unlisted.

Tax offsets vs tax deductions

Unlike the current system where an investment receives an exemption from income tax and capital gains tax once the investment is delivering a return, the new proposed tax offsets will result in investors obtaining a tax deduction up front, and regardless of the success (or otherwise) of the investment.

Changes to ability to access company tax losses

The current 'same business test' will be relaxed to allow businesses to access prior year losses when they have entered into new transactions or business activities. This will encourage entrepreneurship by allowing loss-making companies to seek out new opportunities to return to profitability.

A new and more flexible *'predominantly similar business test'* will be introduced. Under the *'predominantly similar business test'* companies will be able to access losses where their business, while not the same as the business that incurred the tax losses, uses similar assets and generates income from similar sources. The *'predominantly similar business test'* will apply to losses made in the current (FY16) and future income years.

"Whilst the Government's innovation strategy speech has sparked enthusiasm in the Australian economy and the plan is to initiate the majority of the 24 measures from July 2016, the relevant legislation has yet to be passed."

Changes to intangible asset depreciation

Currently, intangible assets with a fixed statutory effective life can't be self-assessed to bring their tax life in line with a shorter economic life of the asset. This can reduce the tax depreciation benefit associated with investment in these assets. For example, a newly acquired patent has a statutory tax life of 20 years, whereas in the fast moving technology area, the commercial life may be far shorter.

A new option to self-assess the tax effective life of acquired intangible assets will be introduced. There will also be an option to continue using the existing statutory effective life of the intangible asset. The changes will apply to assets acquired from 1 July 2016.

The potential for a "Black Hole"

Whilst the Government's innovation strategy speech has sparked enthusiasm in the Australian economy and the plan is to initiate the majority of the 24 measures from July 2016, the relevant legislation has yet to be passed. Furthermore, important details of eligibility and effects have yet to be made available. As such, there could potentially be a 'black hole' for Australian investment in start-ups as hopeful investors hold out for the implementation of these concessions.

The technology, media, and telecommunications (TMT) industry in Australia accounted for 36 per cent of listing values, and 42 per cent of all Initial Public Offerings for the second half of 2015. In light of the potential "black hole" for investment, small business TMT's might find capital raising difficult as investors wait for confirmation of the various tax concessions as laid out in the government's innovation strategy.

Conclusion

The various capital gain concessions and tax exemptions have been designed by the Australian Government as part of an Innovation Strategy to spark economic growth. The "ideas boom", among other things, aims to see these strategies improve the free flow of cash to high potential start-ups and small business enterprises. In light of the waning mining industry, this could be part of the answer to promote strong economic growth in Australia's future. ■

THE NEW ATTRIBUTION MANAGED INVESTMENT TRUST (AMIT) TAX REGIME

In December 2015, the Government introduced draft legislation to significantly alter the way Managed Investment Schemes (MIT's) and their investors are taxed. These new rules arose from proposals that were originally announced in May 2010 and have been the subject of considerable debate and adjustment in the intervening period.

The core principle behind the rules is to move the assessment basis of MIT's away from the rules governed by Division 6 of Income Tax Assessment Act (and the concept of "present entitlement" for its unitholders), to an "attribution of income" methodology in determining the unitholder's share of the income of the trust.

The new rules are contained in complex legislation which will require detailed examination if it applies to your situation, however the key principles, and some practical observations, are outlined in the following table.

Feature	Comment
Eligibility and Timing	
Eligible AMIT's can make an election to enter into the regime for any year commencing on or after 1 July 2016. An optional "early adoption" of the regime from 1 July 2015 exists in certain circumstances.	The election is irrevocable and applies in relation to the year made and all subsequent years of income. Generally, all listed and widely held investment trusts would be expected to meet the requirement for eligibility for election to enter into the regime.
Only MIT's with "clearly defined rights" can chose to be AMIT's.	This is an integrity measure. For example, trusts in which the trustee has significant discretionary powers do not receive the benefits available to AMITs — such as deemed fixed trust treatment.
An AMIT will be deemed to be a "fixed trust" with members deemed to have vested and indefeasible interests in the AMIT.	This is important for applying the trust loss recoupment rules, simplified franking credit rules and for eligibility for unit holders for capital gains tax "scrip for scrip" rollover relief.
Attribution model	
The "attribution" model replaces the Division 6 trust taxation rules and present entitlement rules.	The amounts related to the income and tax offsets of the AMIT, determined by the trustee to be of a particular character, are attributed to members, generally retaining that character.
Members are assessable as advised in the in the AMIT member annual statement (AMMA Statement).	Currently most MIT's advise their members the components of the "net income" through a registry provider and on notices posted on their website. AMIT's will need to be satisfied that their registry services (internal or external) will be able to comply with the new regime.
AMIT's with separate classes of interests can make an irrevocable choice to treat each class as a separate AMIT.	This will enable mulit-class AMIT's to be accommodated within one trust deed structure.
For income tax purposes, members of the AMIT will broadly recognise the amounts attributed to them in the same way that the amounts were recognised by the AMIT.	Amounts of a particular character fall broadly into four main categories: assessable income; exempt income; non-assessable non-exempt income; and tax offsets. Examples of amounts of assessable income that are of a particular character which typically need to be identified by an AMIT include: discount capital gains; non-discount capital gains; dividends, interest or royalties that are subject to withholding tax; and foreign source income. The new rules include guidance on attribution on a "fair and reasonable basis" for the purposes of allocating deductions when working out trust components and treating separate classes as separate AMIT's.

THE NEW ATTRIBUTION MANAGED INVESTMENT TRUST (AMIT) TAX REGIME *CONTINUED*

Feature	Comment
Impact on Unitholders	
Double taxation that might otherwise arise will be reduced because members will now be able to make annual upward adjustments to the cost base of their units in certain circumstances.	Under the current law only downward adjustments are covered.
"Unders and overs" rules will be introduced allowing the trustee to carry forward the differences between distribution statements and final trust tax calculations.	This will avoid the need for unnecessary amendments to investor's tax assessments (usually for individually insignificant amounts). This only applies where the errors did not arise from reckless behaviour or intentional disregard for the law.
Taxation of the Trustee	
The trustee may be taxed where a discrepancy occurs in distributing certain amounts to investors, where unders and overs are not properly carried forward, and where amounts are attributable to foreign residents in some circumstances.	The taxation of the under or over amounts can be avoided if the trustee appropriately carries forward these amounts. The taxation of the amount attributable to non-residents is not materially changed by these new rules.
The trustee may be taxed where an amount of non-arm's length income is included in its trust components. The tax is 30 per cent of the amount deemed to be the non-arm's length consideration.	Transactions with related parties (for example management fees in stapled property trust arrangements) may need to be revisited to ensure that the amounts charged can be justified in a "market value" sense.
Transition Issues	
Whether to elect for the new rules to apply	Is it "worthwhile" or is the "old" Division 6 treatment appropriate having regard to the fund and its investors interests?
Trust Documents	Review the trust deed to determine whether: the "clearly defined rights" requirement is met; it allows attribution of income without present entitlement; and it allows allocation of income and expenses on a "reasonable basis".
Systems	IT systems (or those of the custodian or registry provider) need to be able to deal with attribution, cost base adjustment reporting, under/overs, and compliant reports to investors.
Policy and Process	Revision of policies and processes to meet the new requirements; process for AMMA Statements, tax return; Annual Income Investment Reports (AIIR) information capture and completion; expense allocation; cash distribution policy; arm's length rules; and continuing AMIT eligibility.
Investor Relations	Updated distribution statements and updated tax disclosures in offer documents.
ATO Compliance	Document fund eligibility for AMIT status; potential new tax return; potential new AIIR; and new AMMA in industry standard format.

STEVE WILLIAMS, DIRECTOR

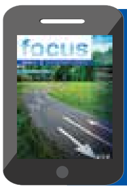
Steve has more than 20 years experience advising companies on corporate tax matters, with a focus on planning and global tax compliance. He was part of a global specialist group that advised clients on tax effect accounting, compliance process re-engineering and effectiveness, global tax compliance monitoring, and risk assessment and reporting under IFRS and USGAAP Contact Steve for advice on tax planning and consolidation, acquisition and divestment of assets, International Tax, Tax Audit and ATO Dispute Resolution matters.

PREVENTING MISTAKES IN THE SALE PROCESS

Many business proprietors fail to achieve their desired result when they sell their company or business due to a lack of planning. In our experience the following list of measures should be undertaken in the process of **selling a business** to ensure that the process flows smoothly and that a successful transaction eventuates:

- Ensure that your advisors have **Confidentiality Agreements** ready for execution by interested parties;
- Undertake a process of putting all the **financial, legal affairs and reporting** of the company into **a pristine state**;
- Ensure that the **legal and financial advisors** you use for the sale process are **experienced** in such a process to avoid the potential of unwelcome surprises;
- Obtain **tax advice** from your accountant or a tax expert so that you are aware of the best manner in which **to structure the sale**;
- Ensure that your advisors prepare **a comprehensive dataroom** so that the **due diligence** process is made easy for the purchaser's advisors and that **adequate disclosures** are made in the sale process;
- Use your advisors to create **a competitive sales process**;
- Be prepared for the **time and effort involved** in the sale process;
- Identify **personnel to be involved** in the sales process whose involvement will not result in the **business being neglected**;
- Have your **legal advisors draft the Sale and Purchase Agreement**, do not let the purchaser dictate terms by having their legal advisors table an agreement and do not rely heavily on a vague and uncertain Heads of Agreement;
- Ensure that you have **a sound understanding of the value of the business**, even if that means having a valuation undertaken beforehand, as that process should ensure that any financial projections in the sale mandate are credible and may well identify weaknesses that can be remedied before the sale process commences;
- Establish **a sale program and timetable** and adhere to it as failing to do so can result in time "defeating" the sale;
- Meet with your advisors regularly to **remain abreast of issues** as they emerge;
- Ensure that your (Sale) **Information Memorandum is focused** on the opportunity presented by the business and the keys to its success;
- Review your **customer and supplier contracts** to determine the extent to which they need to be addressed as a result of any **change of control**;
- Consider carefully **the employee relationships** which could affect value and plan suitable arrangements in advance of the sale; and
- Prepare yourself for the possibility that a purchase offer may include **"earn-out" provisions** and consider in advance the terms which may be acceptable to you.

An experienced advisor can assist you to consider the various aspects of the sale process to ensure that the whole process is designed to prevent mistakes and provide you with the best possible result. ■



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