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## Tax incentives for early stage investors

Investors who purchased new shares in a qualifying early stage innovation company may be eligible for tax incentives.

Last updated 16 August 2024

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## About the tax incentives for early stage investors

Check if you're eligible for tax incentives for early stage investors.

**Last updated** 16 August 2024

From 1 July 2016, if you invest in a qualifying early stage innovation company (ESIC), you may be eligible for the tax incentives for early stage investors – sometimes referred to as 'angel investors', contained in Division 360 of the *Income Tax Assessment Act 1997*.

The tax incentives provide eligible investors who purchase new shares in an ESIC with a:

- non-refundable carry forward tax offset equal to 20% of the amount paid for their eligible investments – this is capped at a maximum tax offset amount of \$200,000 for the investor and their affiliates combined in each income year
- modified capital gains tax (CGT) treatment, under which capital gains on qualifying shares that are continuously held for at least 12 months and less than 10 years may be disregarded – capital losses on shares held less than 10 years must be disregarded.

The maximum tax offset cap of \$200,000 doesn't limit the shares that qualify for the modified CGT treatment.

Investors who don't meet the '**sophisticated investor**' test under the *Corporations Act 2001* won't be eligible for any tax incentives if their total investment in qualifying ESICs in an income year is more than \$50,000.

# Qualifying for the tax incentives

Check if you qualify for the tax incentives.

**Last updated** 9 September 2024

To qualify for the tax incentives, investors must have purchased new shares in a company that meets the requirements of an ESIC immediately after the company issues the shares. The shares must be issued on or after 1 July 2016. If the shares are issued as a result of converting convertible notes, it is the date of the conversion that is relevant.

If the company has satisfied the requirements to qualify as an ESIC and later ceases to be an ESIC, this won't affect the investor's entitlement to the early stage investor tax incentives for the shares.

The early stage investor tax incentives aren't available to you if:

- you didn't purchase the shares in the ESIC directly from the company as newly issued shares
- the shares are not **equity interests** in the ESIC
- you are an **early stage venture capital limited partnership**
- you are a widely-held company or a wholly-owned subsidiary of a widely-held company (a widely-held company is either a company that is listed on an approved stock exchange or a company with more than 50 shareholders – unless certain requirements are met)
- your total investment in one or more ESICs for the income year is more than \$50,000 and you didn't meet the **sophisticated investor test** in relation to at least one of those share offerings
- you or the ESIC are affiliates of each other at the time the shares are issued – an individual or company is an affiliate of another entity where, in relation to their business affairs, the individual or company acts or could reasonably be expected to act in accordance with that entity's directions or wishes or in concert with the entity
- you hold equity interests in the ESIC (including any entities connected with the ESIC) immediately after you are issued with the new shares that carry the right to either:
  - receive more than 30% of any distribution of income or capital by the company or the entities connected with the ESIC, or

- exercise, or control the exercise of, more than 30% of the total voting power in the company or the entities connected with the ESIC

an entity is connected with the ESIC if the entity controls, or is controlled by, the ESIC, or both entities are controlled by the same third entity.

- you acquired the shares under an **employee share scheme** or by exercising a right you acquired under an employee share scheme.

The early stage investor tax incentives are available to both Australian resident and non-resident investors.

If the investor is a **trust or partnership**, special rules apply so that the entitlement to the tax offset and the modified CGT treatment flow through to the member of the trust (a beneficiary, unit holder or object) or partnership (a partner), or to the ultimate member if there is a chain of trusts or partnerships. The tax offset will not flow through to the member if the member is a widely-held company or a wholly-owned subsidiary of a widely held company.


If the investor is a superannuation fund, the trustee of the fund – not the fund members – would be entitled to the tax offset and the modified CGT treatment.

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## The sophisticated investor test

See the requirements to meet the sophisticated investor test.

**Last updated** 9 September 2024

Under the [Corporations Act 2001](#) , 'sophisticated investors' who meet certain requirements don't have to be provided with a disclosure document (such as a prospectus or product disclosure statement), when being offered shares in a company.

You may be a sophisticated investor if you:

- (or, if you are a company or trust, your controller under the *Corporations Act 2001*) hold a [certificate issued by a qualified accountant](#)  that confirms you (or your controller) meet certain asset and income requirements, and the certificate is provided no more than 6 months prior to the qualifying shares being offered to you (as at 19 March 2020, this certificate is available only if you – or your controller – have gross income of at least \$250,000 for each of the last 2 financial years or net assets of at least \$2.5 million)
- have paid at least \$500,000 for the qualifying shares (either as a single offer or including any amounts you previously have paid for shares of the same class that you hold in the same company)
- are offered the qualifying shares through a financial services licensee who is satisfied that you have previous investment experience that allows you to assess the offer and you sign a written acknowledgment that the licensee hasn't given you a disclosure document in relation to the offer
- meet the requirements of being a 'professional investor' under the *Corporations Act 2001* (such as a financial services licensee), or
- have or control gross assets of at least \$10 million (including any assets held by an associate or a trust that you manage).

As a sophisticated investor, your investments are eligible for the early stage investor tax incentives and are not restricted to the amount you can invest in an ESIC in an income year. However, your early stage investor tax offset is capped at a maximum amount of \$200,000 for each income year.

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## Limits for investors who don't meet the sophisticated investor test

There is a limit on the total amount you can invest to access the tax incentives if you don't meet the test.

**Last updated** 16 August 2024

If you don't meet the sophisticated investor test for at least one offer of qualifying shares in an ESIC during the income year, there is a limit on the total amount you can invest to access the tax incentives.

In such a case, your investments in one or more qualifying ESICs in an income year must not exceed \$50,000 in total.

If your total investments exceed \$50,000, you won't be eligible for either of the following:

- the early stage investor tax offset for any of your investments in that income year
- the modified CGT treatment for any of your investments in that income year.

This applies to all the shares that were issued to you in that income year, including to the amount of your investments that are below \$50,000.

This limit is intended to ensure that the tax incentives don't encourage retail investors to be over-exposed to the risk that is inherent in investing in qualifying ESICs.

### **Example: limits for investors who don't meet the sophisticated investor test**

Tim pays \$50,000 for new shares in a qualifying ESIC on 1 October 2016. Tim is not a sophisticated investor for this share offer. This is the maximum amount that he can invest in ESICs in the 2016–17 income year to access the tax incentives (unless he is a sophisticated investor in relation to a later ESIC share offer).

If Tim pays another \$10,000 for qualifying shares in an ESIC or shares in any other company, on 1 November 2016 and is not a sophisticated investor at this time, he won't be entitled to receive any early stage investor tax incentives, including in relation to the shares that he purchased on 1 October 2016.

For more information see [Calculating the early stage investor tax offset](#).

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# Calculating the early stage investor tax offset

How to calculate the early stage investor tax offset.

**Last updated** 16 August 2024

## Tax offsets

The early stage investor tax offset is generally equal to 20% of the total amount received or entitled to be received by the company (including non-cash benefits) in return for the issue of qualifying shares. This doesn't include amounts that can be called on partly paid shares in the future. Investors and their affiliates are entitled to a maximum offset of \$200,000 in an income year. This includes any offsets that are carried forward from prior years' investments and offsets claimed on indirect investments.

An individual or company is an affiliate of an investor if, in relation to their business affairs, the individual or company acts or could reasonably be expected to act in accordance with the investor's directions or wishes, or in concert with them.

The effect of the \$200,000 annual cap is that, for eligible investments of up to \$1 million, a 20% non-refundable carry-forward tax offset is available. Eligible investments by investors and their affiliates that exceed \$1 million in an income year won't increase the amount of tax offset available to them, although the modified CGT treatment will apply to all the shares.

If you don't meet the sophisticated investor test, the maximum early stage investor tax offset you can claim is \$10,000, because your total annual investment in all qualifying ESICs cannot exceed \$50,000.

Tax offsets directly reduce the amount of tax you have to pay, with each dollar of tax offset reducing your tax payable by the same amount. As the early stage investor tax offset is a non-refundable tax

offset, it can reduce your amount of tax payable to zero, but it can't result in a tax refund on its own.

If you don't use all of your early stage investor tax offset in one year, you can carry forward the remaining amount for use in future income years. However, the total amount of early stage investor tax offset that you and your affiliates combined can use or carry forward in an income year cannot exceed \$200,000.

### **Example: calculating the early stage investor tax offset**

Savannah, a sophisticated investor, pays \$4 million for new shares in ESICs during the 2016–17 income year.

Although 20% of the total amount Savannah has paid for the ESIC shares is \$800,000, her entitlement to the early stage investor tax offset is capped at \$200,000 (provided the other eligibility requirements for the incentives are met).

Savannah has an income tax liability of \$50,000 for the 2016–17 income year. She uses \$50,000 of the early stage investor tax offset to reduce her tax payable to zero. Savannah can carry forward the remaining \$150,000 in early stage investor tax offset to future income years.

The modified CGT treatment applies to all of the shares that she purchased.

### **Example: applying the \$200,000 cap – affiliates**

Georgia Co purchases \$2 million of qualifying shares in an ESIC in the 2016–17 income year. Georgia Co and Savannah are affiliates in the 2016–17 income year.

As the \$200,000 maximum cap applies to Savannah and her affiliate Georgia Co, the combined tax offset claimed by Savannah and Georgia Co in the 2016–17 income year cannot exceed \$200,000.

### **Example: applying the \$200,000 cap – carried forward amount**

Jason, a sophisticated investor, carried forward a \$50,000 early stage investor tax offset from the 2016–17 income year. During the 2017–18 income year he pays \$950,000 to acquire qualifying shares in ESICs. Jason's entitlement for the early stage investor tax offset for the 2017–18 income year is \$190,000.

As the \$200,000 maximum cap applies to his 2017–18 income year and carried forward amounts, he can only claim the \$50,000 carried forward amount plus \$150,000 of the 2017–18 income year amount. The balance of the 2017–18 income year amount (\$40,000) can neither be claimed nor carried forward to future years.

For more information see:

- [Qualifying as an early stage innovation company](#)
- [For early stage innovation companies \(ESICs\)](#)
- [For investors](#)

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## **Qualifying as an early stage innovation company**

Tests that determine if a company will qualify as an early stage innovation company (ESIC).

**Last updated** 9 September 2024

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## Qualify as an ESIC

For an investor to be entitled to the early stage investor tax incentives, the company they invest in must qualify as an Early Stage Innovation Company (ESIC) immediately after the new shares are issued to the investor. If the company no longer meets the ESIC requirements after this test time, this won't affect the investor's entitlement to these tax incentives.

A company will qualify as an ESIC if it is not a foreign company under the *Corporations Act 2001* and meets both:

- the [early stage test](#)
- either one of the following:
  - [100-point innovation test](#)
  - [principles-based innovation test](#).

When compared to the principles-based innovation test, the 100-point innovation test is likely to be the simplest way to determine a company's eligibility. The 100-point test is an objective test and should be self-assessed.

A company can choose to request a ruling from the ATO on whether it qualifies as an ESIC under the principles-based innovation test. Refer to [companies and investors](#) for more information on requesting a ruling.

The investor must determine whether they are eligible for the early stage investor tax incentives. The onus is on the investor to confirm that the company qualifies as an ESIC at the relevant test time. If the investor has claimed for tax incentives and the company is later found

not to be an ESIC at the relevant test time, the investor will need to amend their claims. The investor should keep records to support their entitlement to the early stage investor tax incentives.

### **Example: early stage investor tax offset**

On 1 June 2017, Thomas (a sophisticated investor) pays \$100,000 for new shares issued in Sweeney Co, an ESIC. If Thomas meets all of the eligibility requirements, he is entitled to an early stage investor tax offset of \$20,000.

In determining whether Thomas is entitled to early stage investor tax incentives for the shares, Sweeney Co's status as an ESIC is tested at the point in time immediately after Thomas was issued with the new shares on 1 June 2017.

If there is a change after this point in time which results in Sweeney Co no longer qualifying as an ESIC, this won't affect Thomas' entitlement to the tax offset or the modified CGT treatment for the shares.

## **Early Stage Innovation Company test requirements**

To meet the Early Stage Innovation Company test, the company must meet 4 requirements.

These requirements are tested at the point in time immediately after the company issues the shares to the investor. A company must meet all requirements at that point in time to qualify as an ESIC. If they do not qualify, the investor won't qualify for the tax incentives for those shares.

The 4 requirements are:

- [The company must have been incorporated or registered in the Australian Business Register](#)
- [The company \(plus any wholly-owned subsidiaries of the company\) must have total expenses of \\$1 million or less in the previous income year](#)

- [The company \(plus any wholly-owned subsidiaries of the company\) must have assessable income of \\$200,000 or less in the previous income year](#)
- [The company's equity interests are not listed on any stock exchange.](#)

## **The company must have been incorporated or registered in the Australian Business Register**

The company must have been within the last 3 income years (the latest being the current income year in which the requirement is tested):

- incorporated in Australia, or
- registered in the Australian Business Register (ABR).

If neither of the these apply, both of the following requirements must be met:

- the company was incorporated in Australia within the last 6 income years (the latest being the current income year at the test time)
- the company and its wholly-owned subsidiaries had expenses of \$1 million or less across the last 3 income years before the current income year (see below for the meaning of 'expenses').

## **The company (plus any wholly-owned subsidiaries of the company) must have total expenses of \$1 million or less in the previous income year**

'Expenses' for the purposes of the early stage requirements are accounting expenses incurred by the company. This doesn't include depreciation expenses, and provisions and reserves of a kind that are not incurred expenses.

Taxation Determination TD 2023/6 *Income tax: tax incentives for early stage investors: what is an 'expense' that is 'incurred' for the early stage test?* explains 'expenses' and 'incurred' in more detail.


The total of expenses reported at item 6 of the company tax return, if correctly reported, can be used to show that total expenses requirements are met.

However, you don't need to use the total at item 6 Expenses. You can choose to work out total expenses directly if:

- the company wasn't required to lodge tax returns in relevant years; or
- the item 6 expenses total includes amounts that are not accounting expenses incurred by the company

### **The company (plus any wholly-owned subsidiaries of the company) must have assessable income of \$200,000 or less in the previous income year**

Companies that had no assessable income in the previous income year will meet this requirement.

In determining the company's assessable income, any amount of [Accelerating Commercialisation Grant](#)  that the company received in that year is disregarded.

Any amounts which are required to be included as a clawback amount in assessable income for a Research & Development entity is also to be disregarded from the \$200,000 assessable income threshold.

### **The company's equity interests are not listed on any stock exchange**


The company's equity interests are not listed for quotation in the official list of any stock exchange, either in Australia or a foreign country.





## **100-point innovation test requirements**



To qualify under the 100-point innovation test, the company must obtain at least 100 points by meeting certain objective innovation criteria. This is tested immediately after the relevant shares are issued to the investor (the test time).

If a company doesn't meet either the 100-point innovation test or principles-based innovation test at the test time, the investor won't qualify for any early stage investor tax incentives in relation to those shares.

### **Table: 100-point innovation test**

Points	Criteria
75 points	At least 50% of the company's total expenses for the previous income year are <b>eligible notional deductions</b> for the research and development tax incentive.
75 points	The company has received an <a href="#">Accelerating Commercialisation Grant</a>  at any time. The amount of this grant is also excluded from the company's assessable income for the purposes of the early stage test.
50 points	At least 15% but less than 50% of the company's total expenses for the previous income year are <b>eligible notional deductions</b> for the research and development tax incentive.
50 points	<p>The company has completed or is undertaking an eligible accelerator program that provides time-limited support for entrepreneurs with a start-up business. This support may involve providing mentorship, training, education and access to networks.</p> <p>The program must be provided to entrepreneurs that are selected in an open, independent and competitive manner. It is likely that an entity that has been selected through this process would also meet the <a href="#">principles-based innovation test</a>.</p> <p>The entity providing the program must have been providing eligible programs for at least 6 months, and the programs must have been completed by at least one cohort of entrepreneurs.</p>
50 points	<p>One or more third parties have previously paid a total of at least \$50,000 for the issue of new shares in the company.</p> <p>These points are only available if:</p> <ul style="list-style-type: none"> <li>• the third party was not an associate of the company immediately before it was issued with the shares</li> <li>• the company issued the third party with the shares at least one day before the test time</li> </ul>

	<ul style="list-style-type: none"> <li>• the third party did not purchase those shares primarily to assist another entity to become entitled to early stage investor tax incentives.</li> </ul> <p>Examples of entities that would be an associate of a company include:</p> <ul style="list-style-type: none"> <li>• a partner of the company or a partnership in which the company is a partner</li> <li>• a trustee of a trust estate under which the company or associate benefits</li> <li>• another entity (including a person) that, acting alone or with another entity or entities, sufficiently influences the company</li> <li>• an entity (including a person) that, either alone or together with associates, holds a majority voting interest in the company</li> <li>• a second company that is sufficiently influenced by the company or the company's associates</li> <li>• a second company in which a majority voting interest is held by the company or the company's associates.</li> </ul>
<p><b>50 points</b></p>	<p>A company has enforceable rights on an innovation through:</p> <ul style="list-style-type: none"> <li>• a <a href="#">standard patent</a>  granted in Australia in the last 5 years</li> <li>• a <a href="#">plant breeder's right</a>  that has been granted in Australia in the last 5 years, or</li> <li>• an equivalent intellectual property right granted in another country in the last 5 years.</li> </ul> <p>A company that holds a licence to intellectual property owned by another party is able to obtain these points.</p>
<p><b>25 points</b></p>	<p>A company has enforceable rights on an innovation through:</p> <ul style="list-style-type: none"> <li>• an <a href="#">innovation patent</a>  granted in Australia in the last 5 years</li> <li>• <a href="#">design right</a>  granted in Australia in the last 5 years, or</li> </ul>

	<ul style="list-style-type: none"> <li>• an equivalent intellectual property right granted in another country in the last 5 years.</li> </ul> <p>A company that holds a licence to intellectual property owned by another party can obtain these points. These points are only available if the company did not receive 50 points for holding a standard patent, plant breeder's right or equivalent right overseas under the previous criterion.</p>
<b>25 points</b>	<p>The company has a written agreement to co-develop and commercialise an innovation with:</p> <ul style="list-style-type: none"> <li>• an institution or body listed in <a href="#">Schedule 1 to the Higher Education Funding Act 1988</a> , or</li> <li>• an entity registered as a <a href="#">Research Service Provider</a>  under section 29A of the <i>Industry Research and Development Act 1986</i>.</li> </ul>

The legislation contains a [regulation-making power](#) which provides flexibility for further points to be added for meeting additional innovation criteria.

## Principles-based innovation test

To qualify under the principles-based innovation test, the company must meet 5 requirements. This is tested immediately after the new shares are issued to the investor.

The company must be able to demonstrate how it meets each of the requirements using existing documentation, such as a business plan, commercialisation strategy or competition analysis.

The company must be able to show that tangible steps have been, or will be, taken in relation to each of the requirements.

The principles-based innovation test has different requirements to the eligibility tests for the **research and development tax incentive**. Spending a significant amount on research and development activities is only one indicator that the company may be eligible under the principles-based innovation test.

A company can choose to seek a ruling on whether it qualifies under the principles-based innovation test. Refer to information on

requesting a ruling, for both companies and investors.

The legislation also contains [regulation-making power](#) that can be used to alter the application of the principles-based innovation test.

## Principles-based innovation test requirements

There are 5 requirements of the principles-based innovation test:

- [The company must be genuinely focused on developing one or more new or significantly improved innovations for commercialisation](#)
- [The business relating to that innovation must have a high growth potential](#)
- [The company must demonstrate that it has the potential to be able to successfully scale up that business](#)
- [The company must demonstrate that it has the potential to be able to address a broader than local market, including global markets, through that business](#)
- [The company must demonstrate that it has the potential to be able to have competitive advantages for that business.](#)

### **The company must be genuinely focused on developing one or more new or significantly improved innovations for commercialisation**

The innovation that is being developed by the company must be either new or significantly improved in relation to the addressable market. For example, if the addressable market is the Australian market, then the innovation must be new or significantly improved in relation to that market.

An innovation could be a product, process, service, or marketing or organisational method.

A company's addressable market refers to the available revenue opportunity or market demand arising from the innovation, or from the business that relates to that innovation. The addressable market identified by the company must be objective and realistic.

Examples of improvements that are unlikely to be considered new or significantly improved innovations include:

- customising an existing product

- a minor extension, such as an update to existing equipment or software
- changes to pricing strategies
- changes to goods resulting from cyclical or seasonal change
- trading of new products for a wholesaler, retail outlet or distribution business where the activities are similar to the approach of competitors
- ceasing to utilise a process or method.

The company must be genuinely focused on developing the innovation for a commercial purpose to generate economic value and revenue for the company. This requirement draws the distinction between simply having an idea and commercialising an idea.

'Commercialisation' includes a range of activities that involve the implementation or sale of a new or significantly improved innovation that will directly lead to the generation of economic value for the company.

**Example: a company that is not developing a new or significantly improved innovation for commercialisation**

PQ Technology Co is a new wholesale distribution company specialising in wearable technology products. It begins to sell a new product that was released by one of its offshore suppliers.

Even though the product is new to the Australian market, PQ Technology Co has not developed a new or significantly improved innovation for commercialisation. Therefore, it would not meet the principles-based innovation test.

**The business relating to that innovation must have a high growth potential**

The company must be able to demonstrate that it has the potential for high growth within a broad addressable market.

This can be distinguished from typical small to medium sized enterprises such as a café, local retail store or local service provider that services a local market. As these enterprises are limited to

supplying to local customers, they don't have the potential for high growth within a broad addressable market.

**Example: a business relating to an innovation that has a high growth potential**

Allen Co is a company that is developing a new mobile app that provides specialised on-demand concierge services for the convenience of its users. While Allen Co is initially testing its service in Melbourne, it can demonstrate its high growth potential through its ability to expand the use of its mobile platform and the location of the services to include all major cities in Australia and beyond.

The company has outlined this expansion strategy in its business plan and has started to contact service providers in other major cities. Therefore, Allen Co can demonstrate that the business relating to its innovation has a high growth potential.

**The company must demonstrate that it has the potential to be able to successfully scale up that business**

The company must have the potential to successfully scale up its business. This means that the company must have operating leverage as it increases its market share or enters into new markets, where its existing revenues can be multiplied with a reduced or minimal increase in operating costs.

**Example 1: a company with the potential to successfully scale up the business**

Siegel Co is a start-up manufacturing company that is developing a new formula for a perishable consumer goods product that allows the product to have an extended shelf life.

The company has outlined its strategy to purchase its own manufacturing plant as the demand for its product grows. If production is increased, the company has indicated that the cost per unit can be reduced by leveraging the existing operating costs of the plant as it sells the product into new markets.

Therefore, Siegel Co will be able to demonstrate that it has the potential to successfully scale up the business.

**Example 2: a company that doesn't have the potential to successfully scale up the business**

Balthazar Co is a new local service provider of dental care. The company's growth strategy is to expand its number of clinics. However, as Balthazar Co opens more clinics, its operating costs (such as rent and wages) increase in proportion to the additional revenue generated. Consequently, Balthazar Co doesn't meet the principles-based innovation test as it does not have the potential to successfully scale up its business.

**The company must demonstrate that it has the potential to be able to address a broader than local market, including global markets, through that business**

The company must demonstrate that it has the potential to address a market that is broader than a local city, area or region.

While the company doesn't need to have a serviceable market at a national, multinational or global scale at the test time, it needs to show that it is capable of addressing a market that is broader than a local market. It must also show that its business can be adapted to a national, multinational or global scale in future.

**Example: a company with potential to address a broader than local market**

Allen Co, the developer of the new mobile app providing an on-demand concierge services, plans to initially test and sell its new product to Victorian consumers. If the test is successful, it plans to eventually adapt its product for the Asia-Pacific market. As a result, Allen Co has the potential to service a broader than local market and to adapt its business to access global markets.

## **The company must demonstrate that it has the potential to be able to have competitive advantages for that business**

The company must demonstrate that it has the potential to have competitive advantages (such as cost or differential) over its competitors, that are sustainable for the business.

For example, if a product provides unique benefits to the customer, this may be a differential advantage that sets the company apart from its competitors.

One method of testing whether the company has competitive advantages could be to measure the level of value provided to customers relative to its competitors. It can also consider whether the product is rare, whether it is capable of being imitated or whether substitute products are readily available.

### **Example: a company with the potential to have competitive advantages**

STS Tech Co is developing a new peer-to-peer service-providing website for the Australian market. After conducting a competition analysis of the marketplace, a differentiating competitive advantage identified was the website's use of a marketplace platform.

STS Tech Co has identified that this feature will allow the company to outperform its competitors. In addition, the company has taken initial steps in developing the platform and has also started to engage with service providers to be part of the website's network. As a result, STS Tech Co can demonstrate that it has the potential to have competitive advantages.

## **Regulation-making powers in legislation**

The legislation contains regulation-making powers that can be used to:

- exclude a particular activity or form of type of innovation from being able to meet the principles-based innovation test
- exclude a company from qualifying as an ESIC if it carries on a particular type of activity

- add points to the 100-point innovation test for meeting certain additional criteria.

This is intended to provide flexibility should the government wish to target the tax incentives more tightly in the future, or if the incentives are being used for inappropriate purposes. If the rules are tightened by regulation, any exclusions will apply going forward, rather than retrospectively.

For more information see:

- For early stage innovation companies (ESICs)
- For investors
- ESIC decision tool
- Schemes to qualify for the tax incentives

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## For early stage innovation companies (ESICs)

Information for ESICs including requesting a ruling, what you need to report and how to report.

**Last updated** 16 August 2024

### On this page

Can a company request a ruling on the tests?

What you need to report to us

How you report to us

## Can a company request a ruling on the tests?

Companies may choose to apply for a ruling from the ATO about whether they meet the principles-based innovation test.

The ruling is only about how the tax law applies to the facts that you have provided. If the facts change, this may lead to a different outcome under the tests.

The ruling should not be used in promotional materials to imply that we guarantee or endorse investment in your company.

The promoter penalty laws may apply if you use a ruling to encourage investors to invest in your company, when the company's circumstances at that time are materially different to those covered by the ruling.

## What you need to report to us

Companies are required to complete an early stage innovation company report if they issue new shares to one or more investors during a financial year that could lead to an investor being entitled to access the early stage investor tax incentives.

For each investment that you receive during the year that may give rise to an investor accessing the tax incentives, you should keep the following information to report to us:

- ABN, name and address for the investor (plus the date of birth for investors that are individuals)
- number of new shares issued to the investor
- amount paid for the new shares
- date the shares were issued
- percentage of shares in the company held by the investor immediately after the shares were issued.

When you submit the form, you are declaring that the company meets the requirements to be an ESIC for all the reported investments. You will be asked to specify whether the 100-point innovation test or principles-based innovation test has been applied and whether you have received a ruling on your eligibility.

Submitting the form when you are aware that the company doesn't meet these requirements could result in penalties, including possible criminal penalties, under the tax law.



We use this information to assess whether investors qualify for these tax incentives. Providing this information early may help your investors demonstrate to us that they are entitled to the early stage investor tax offset, if they lodge their tax return early.

If you are aware that a particular investor is not entitled to access the early stage investor tax incentives, then you should not include the details for that investor on the form. For example, this will be the case if the investor is an affiliate of yours or if the shares are provided through an employee share scheme.

## How you report to us

You must report the information to us 31 days into the following financial year (this is generally 31 July).

Companies need to report this information electronically. The Early stage innovation company report form is available in:

- [Online services for business](#)  – log in and select **Lodgments** from the top menu then **Reports and forms**, or
- [Online services for agents](#)  under **Client forms** in the left-hand menu.

Lodgment tips:

- Users must have the **correct permissions** set by their Administrator in Access Manager to view and lodge the form.
- The report may timeout after 5 minutes of inactivity.
- Don't use copy and paste.
- If you continually get a system unavailable error message when attempting to lodge, email us at [R&DandVCLiaison@ato.gov.au](mailto:R&DandVCLiaison@ato.gov.au) for help.
- If you are an 'Online Services for Business' user and can't see the ESIC report in your online forms, and you have checked you have the correct access permissions, email us at [R&DandVCLiaison@ato.gov.au](mailto:R&DandVCLiaison@ato.gov.au) to arrange access.

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## For investors

Information for investors including what if the company has a ruling and how to claim the offsets and more.

**Last updated** 9 September 2024

### On this page

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How the tax offset affects PAYG income tax instalments

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## What if the company has a ruling on the tests

The ruling only applies to the facts that the company has provided in their ruling request.


Your eligibility for the early stage investor tax incentives will depend on your circumstances as well as whether the company meets the ESIC requirements at the time immediately after it issued you with new shares.

You should make enquiries to confirm that there has been no change in the company's activities after it has received a ruling that could lead to a different outcome under the tests. You should also consider whether you are eligible as an investor.

The ruling provided to the company doesn't amount to financial advice or imply that we endorse or guarantee investment in the company. Investors should form their own views about whether to invest in a company and should seek independent financial advice if needed.

## **How I claim the early stage investor tax offset**

You can claim the early stage investor tax offset in your income tax return. If you don't use all of your tax offset in that income year, you can carry it forward for use in future income years.

As with other non-refundable carry-forward tax offsets, you should apply the early stage investor tax offset only after applying any tax offsets that can't be carried forward. This ensures that you don't lose the benefit of non-carried forward tax offsets. The order in which you should apply tax offsets is provided in subsection 63-10(1) of the [Income Tax Assessment Act 1997](#) .

## **How the tax offset affects PAYG income tax instalments**

The early stage investor tax offset that you receive in an income year is not taken into account in determining your ATO-calculated PAYG instalment amounts for the following year.

If your PAYG instalments do not reflect your end-of-year tax situation because you expect to claim the early investor tax offset, you may wish to correct your PAYG instalments.

## **Can a member of a trust or partnership be eligible for the early stage investor tax offset?**

A member of a trust (a beneficiary, unit-holder or object) or partnership (a partner) may be entitled to the early stage investor tax offset if all the following apply:

- they are a member of the trust or partnership at the end of the income year

- the trust or partnership would be entitled to the tax offset for that income year if it were an individual investor
- they are not a widely held company or a 100% subsidiary of a widely held company.

If the members of a trust or partnership include another trust or partnership, the tax offset passes to the ultimate member that is not a trust or partnership.

## **Determining a member's early stage investor tax offset amount**

The amount of early stage investor tax offset to which a member of a trust or partnership is entitled is calculated as the amount of the offset that would be available to the trust or partnership if it were an individual investor, multiplied by the percentage determined for the member. The \$200,000 annual cap also applies to the member's entitlement.

The partnership or trustee of a trust determines the member's percentage in working out their tax offset amount. If the partnership or trustee doesn't make a determination, or if part of the early stage investor tax offset is not allocated to any member, then no member will be entitled to that amount of the tax offset.

If, under the terms of a trust or partnership, a member would be entitled to a fixed proportion of any capital gain on the disposal of the qualifying shares, then the member's percentage determined by the trustee or partnership must equal that fixed proportion. Otherwise, there are no requirements as to how the tax offset is allocated to a member.

The total amount of early stage investor tax offset from all members of the trust or partnership can't exceed 100% of the amount that the trust or partnership would be entitled to if it was an individual investor.

The partnership or trustee of the trust must notify the member in writing of their entitlement to the tax offset within 3 months after the end of the income year.

### **Example 1: entitlement to fixed proportion of trust capital gains and tax offset amounts**

Sladja and Roger are unitholders in Manakau Unit Trust. The trustee is required to distribute all capital gains made by the trust to Sladja and Roger in proportion to the number of units that they each hold at the end of the year. At the end of the 2016–17 income year, Sladja owns 80% of the units and Roger owns 20%.

If the Manakau Unit Trust were an individual investor, it would be entitled to claim an early stage investor tax offset of \$200,000 in the 2016–17 income year. Therefore, the trustee must determine that Sladja's tax offset amount as \$160,000 and Roger's share as \$40,000.

The trustee must give a written notice to Sladja and Roger advising each of them of their entitlement to the tax offset within 3 months after the end of the 2016–17 income year (or such further time as the Commissioner may allow).

### **Example 2: discretionary entitlements to capital gains**

Matt and Carolyn are beneficiaries of the Koru trust. If the Koru trust were an individual investor, it would be entitled to claim an early stage investor tax offset of \$10,000 in the 2016–17 income year.

Under the terms of the Koru trust, the beneficiaries have no entitlement to receive distributions of any capital gains until such time as the trustee exercises its power of appointment in their favour.

The trustee determines that Carolyn and Matt will each be entitled to a tax offset amount of 50% of \$10,000 for the 2016–17 income year.

The trustee must give a written notice to Matt and Carolyn advising each of them of their entitlement to the tax offset within 3 months after the end of the 2016–17 income year.

## **What if the trustee is liable for tax**

A trustee of a trust is entitled to an early stage investor tax offset if both:

- the trust would be entitled to the tax offset if it were an individual
- the trustee is liable to pay tax on all or part of the net income of trust (under sections 98, 99 or 99A of the *Income Tax Assessment Act 1936*).

The amount of tax offset available to the trustee is the amount that would be available to the trust if it were an individual investor, less any amount of the tax offset to which the beneficiaries are entitled that relate to the same ESIC shares giving rise to the trustee's tax offset entitlement.

## **How CGT applies to qualifying shares**

If you acquire shares in a qualifying ESIC, you are taken to hold the shares on capital account, rather than revenue account. This means that, for example, when you sell the shares, this will give rise to a capital gain or capital loss, rather than other income tax consequences.

The maximum cap of \$200,000 that applies for the early stage investor tax offset doesn't limit the shares that qualify for the modified CGT treatment.

However, if you exceed the \$50,000 investment limit for investors who don't meet the sophisticated investor test, you won't receive either the early stage investor tax offset or the modified CGT treatment for any shares acquired in that income year.

The early stage investor tax incentives have various requirements for investors and the company that are tested at specified times – for example, at the time of the share issue (affiliate test) or immediately after (investors not to have equity interests that carry the right to receive more than 30% of any income or capital distribution or to control the exercise of more than 30% of total voting power; and the company must qualify as an ESIC). This means that, if you or the company no longer meet the eligibility requirements after the relevant times, this doesn't affect your entitlement to either the tax offset or the modified CGT treatment for those shares.

How the CGT rules apply to your qualifying shares will depend on how long you hold the shares before a CGT event happens to them (such

as the sale of the shares) and whether you make a capital gain or capital loss from the CGT event.

### **Qualifying shares held for less than 12 months**

If you continuously hold qualifying shares for less than 12 months before a CGT event happens to the shares, any capital gain you make from the event is not disregarded.

However, you must disregard any capital loss you make from a CGT event that happens to the shares during this period.

### **Qualifying shares held for 12 months or more but less than 10 years**

You can disregard a capital gain that you make from a CGT event happening to qualifying shares if you have held them continuously for 12 months or more but less than 10 years.

However, you must disregard a capital loss that you make from a CGT event happening to the shares during this period.

### **Qualifying shares held for 10 years or more**

If you have continuously held a qualifying share for 10 years, the first element of the cost base and reduced cost base for the share will become its market value on the tenth anniversary of the share being issued to you. This means that you will recognise any capital gains or losses that happen from this point in time.

We provide guidance and advice products that deal with market valuation for tax purposes, and accepted principles of valuation which are equally applicable to shares that are not listed on a stock exchange.

## **How the modified CGT treatment applies to a roll-over**

Generally, special rules apply to preserve the modified CGT treatment for qualifying shares when you apply a CGT roll-over. However, the modified CGT treatment is terminated when you apply certain roll-overs.

If a **same asset roll-over** applied to a qualifying share, the share is taken to have been acquired by the new entity at the same time as when it was originally issued by the ESIC to the original investor. Therefore, the modified CGT treatment is preserved in the hands of the new entity.

If a **replacement asset roll-over** (other than a scrip for scrip or newly incorporated company roll-over) applied to a qualifying share, the replacement asset is taken to have been acquired by the investor at the same time the share in the qualifying ESIC was originally issued. Therefore, the modified CGT treatment is preserved for the replacement asset, as though it was the original asset you purchased.

However, if a **scrip for scrip** or newly incorporated company roll-over applies to a qualifying share after the first anniversary, but before the tenth anniversary, of its issue, the share is taken to have a first element of the cost base and reduced cost base equal to its market value immediately before it is exchanged under the roll-over. This rule means that the modified CGT treatment is terminated, but that any capital gains or losses on the share before the roll-over is applied are not recognised when the replacement asset is sold.

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## ESIC decision tool

The decision tool will help you work out if you're eligible for the tax offset and if a company qualifies as an ESIC.

**Last updated** 16 August 2024

- The ESIC decision tool will help you work out if:
- you're eligible for the tax offset
- a company qualifies as an ESIC.

### Note

- This calculator provides general guidance outcomes based on your responses to the questions.

- Since the ESIC legislation only started on 1 July 2016 and contains new tax policy, you shouldn't rely on this decision tool alone.
- The tool can only be used to determine the ESIC status of companies with a normal balance date of 30 June.

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## Schemes to access the tax incentives

See rules that prevent taxpayers from obtaining tax benefits by entering into contrived or artificial arrangements.

**Last updated** 2 January 2025

The general anti-avoidance provisions in Part IVA of the *Income Tax Assessment Act 1936* may apply to schemes that are used to access the tax incentives for early stage investors, including both the tax offset and the modified capital gains tax treatment.

These rules apply to prevent taxpayers from obtaining tax benefits by entering into contrived or artificial arrangements to access the tax incentives. Where the conditions in Part IVA are satisfied, the Commissioner of Taxation can cancel the relevant tax benefits.

For more information, see Taxpayer Alert TA 2024/1 *Early stage investor tax offset claimed using circular financing arrangements*.

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**Our commitment to you**

We are committed to providing you with accurate, consistent and clear information to help you understand your rights and entitlements and meet your obligations.

If you follow our information and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we will take that into account when determining what action, if any, we should take.

Some of the information on this website applies to a specific financial year. This is clearly marked. Make sure you have the information for the right year before making decisions based on that information.

If you feel that our information does not fully cover your circumstances, or you are unsure how it applies to you, contact us or seek professional advice.

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