

# **The Journey – R & D to Capital Raising**

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# The Journey – R & D to Capital Raising

1. Research and Development
2. Early Stage Innovation Company
3. Investors ESIC
4. Crowd-Sourced Funding Equity Raising
5. CSF Investor Opportunities
6. Questions

# The Journey – R & D to Capital Raising

## 1. Research and Development

# Research and Development

- To claim the R & D Tax Rebate the business must be a company
- R & D Rebate depends on the company's turnover:
  - Under \$20 million – 43.5%
  - Over \$20 million – 38.5%

# Research and Development Overview (cont'd....)

- Company needs to complete a registration with AusIndustry for R & D expenditure in a financial year by 30<sup>th</sup> April the following year or date of lodgement of the company's tax return – whichever is the earlier
- To claim the rebate R & D expenditure in a financial must exceed \$20,000

# Research and Development Overview (cont'd....)

- Document what the R & D project is about:
  - What is the problem?
  - What do you hope to achieve?
  - Give the project a name and number
  - Record time worked on the individual R & D projects
  - Allocate material, contractor costs etc., to individual R & D project number

# Research and Development Overview (cont'd....)

- If you are using non-employees in the project you need:
  - Signed “Confidentiality Agreements”
  - Signed “Assignment of Intellectual Property”

# Research and Development Overview (cont'd....)

- If you are working cooperatively on a project:
  - Prepare an Enterprise Agreement:
    - Who does what
    - Financial contribution
    - Ownership



# Research and Development Overview (cont'd....)

- Conduct the R & D activities in a systematic, investigative manner
- The R & D should involve innovation or high levels of technical risk

# Research and Development Overview (cont'd....)

- Is the purpose of the R & D activities to acquire new knowledge or create new or improved materials, products, devices, processes or services?
- Is the activity involved with the development of computer software?
- Is the purpose for sale or rent?

# Research and Development Overview (cont'd....)

- Is the aim to develop a new software product for multiple sales?
- You cannot claim research and development tax rebate on the development of computer software exclusively for internal use within your business

# Research and Development Overview (cont'd....)

- Will the overseas component of the R & D (if any) be less than 10% of the total R & D project?
- If the overseas component is going to exceed 10% you need to submit a special application to the ATO for approval for the extra overseas expenditure to be included in the claim for R & D rebate

# Research and Development Overview (cont'd....)

- Will the R & D results be exploited on normal commercial terms?
- What other technical goals is this project trying to achieve?
- What other commercial goals for this project?
- What is the “knowledge gap” that you are trying to answer?

# Research and Development Overview (cont'd....)

- The following items are not eligible core activities for the R & D rebate:
  - Market research, market testing, market development or sales promotion
  - Quality control
  - Prospecting, exploring or drilling

# Research and Development Overview (cont'd....)

- The making of cosmetic modifications or stylistic changes
- Research in social sciences, arts or humanities
- Preproduction activities, such as demonstration of commercial viability, tooling up and trial runs
- Routine collection of information, except as part of the R & D process

# Research and Development Overview (cont'd....)

- Preparation for teaching
- Commercial, legal and administrative of aspects of patenting, licensing or other activities
- Activities associated with complying with statutory requirements



# Research and Development Overview (cont'd....)

- Other matters to consider in an R & D project include:
  - An awareness of the process to register a patent
  - Some discussions with a patent attorney
  - Ongoing record-keeping of a project on, at least, a monthly basis but in many cases on a weekly basis

# Research and Development Overview (cont'd....)

- Awareness of the requirement not to publicise research before a patent application has been lodged
- Establishment of a system to ensure that all of the records relating to a R & D project and the costs of the R & D project including labour, labour on-costs, overhead charges, materials and contractor charges have been documented on a monthly basis



## 2. Early Stage Innovation Company

# Objective Of Early Stage Innovation Company

- The object of an Early Stage Innovation Company (ESIC) is to encourage new investment in small Australian innovation companies:
  - With high growth potential
  - By providing qualifying investors with a tax offset
  - And a modified Capital Gains Tax treatment

# Objective Of Early Stage Innovation Company (cont'd...)

- The benefit for qualifying companies is that they will have an advantage over other companies seeking to raise capital
- To be an ESIC, the company must qualify under Test 1 and either Test 2 or Test 3

# A. Inventors/Small Medium Enterprises

- Companies need to qualify under two of three tests:
  - Early Stage Test – all companies must qualify
  - Gateway Test – if the company does not qualify under this test can then move onto
  - The Principles Test

# A. Inventors/Small Medium Enterprises

## Early Stage Test

- Company less than 3 years old?
- Company over 3 but less than 6 years old?
- 2015/16 financial accounts:
  - Total expenditure under \$1M?
  - Total income under \$200,000 (not including any grant income from Accelerating Commercialisation Grant)
  - Research and development expenditure?
- Was the company listed on a stock exchange?

# A. Inventors/Small Medium Enterprises (cont'd...)

## Gateway Test

- R & D expenditure – over 15% of expenditure?
- Admitted to Accelerating Commercialisation Programme?
- Participated in an Accelerator Programme?
- Does your company have registered:
  - Patents?
  - Plant breeder's rights?
  - Innovation patents?
  - Registered designs?



## A. Inventors/Small Medium Enterprises (cont'd...)

- Have “arms-length” investor(s) contributed \$50,000 or more?
- Do you have Commercialisation Agreements?
- To qualify must earn at least 100 points

# A. Inventors/Small Medium Enterprises (cont'd...)

## The Principles Test

- Has your company developed new or improved:
  - Products?
  - Processes?
  - Services?
  - Marketing? Of
  - Organisational methodologies?

# A. Inventors/Small Medium Enterprises (cont'd...)

## The Principles Test

- Applies if:
  - The company is generally focused on developing for “commercialisation” one or more new or significantly improved products, processes, services or marketing or organisational methods
  - The business has a “high growth potential”
  - The company can demonstrate potential to successfully “scale that business”

# A. Inventors/Small Medium Enterprises (cont'd...)

## The Principles Test (cont'd...)

- Applies if:
  - The company can demonstrate the potential to address a “broader than local market”
  - The company can demonstrate the potential to have “competitive advantages”

# Most Companies Will Need Assistance

- The Principles Based Tests are very subjective
- Most companies will need assistance to answer the questions

# Most Companies Will Need Assistance

- One company (Epic Delivery – Perth) claimed in the Financial Review 11.11.16 *“that the company had received 9 or 10 emails with a stack of questions in each over the two month period from the ATO”*
- These questions related to the answer submitted for *“does the company have a sustainable competitive advantage for its products?”*

# Need to Include Detailed Answers

- Each of the five questions needs to be answered in detail
- Key points for “competitive advantage” include:
  - The products cost of differential advantage over competitors
  - Competitive advantage relative to the value for customers
  - Rarity of the product
  - Products differentiation
- If at all possible, companies should qualify using the Gateway Test

# Self-Assessment

- The self-assessment process needs to be conducted at a date when an investor is proposing to invest (Test Time)
- For this process, the company's accountant/adviser will prepare a detailed file of the supporting evidence and documentation for review and signing by the company's directors



# Self-Assessment

- The directors should sign statements as to which “test” the directors are claiming ESIC status under and at what date e.g.:
  - Gateway Test; or
  - Principles Based Test
- Most companies will benefit from due diligence assistance in the self-assessment process

# Report for Investors

- Investors will expect companies to produce a computer file containing various statements and supporting evidence to substantiate that the company has professionally conducted the self-assessment process at the test time including:

## Early Stage Test

- Proof of:
  - Expenditure
  - Income

# Report for Investors (cont'd....)

- Certificate of Incorporation
- Statement relating to Stock Exchange listing

## Gateway Test:

- Individual statements for items that points earned from
- Supporting documentation

## Principles Based Test:

- Supporting documentation relating to the five questions
- External expert's report (if obtained)
- Report from the accountant/adviser who assisted in the due diligence process

# Determination Of Status

- If the company is unable to satisfy itself or a potential investor as to whether it meets the requirements of the ESIC legislation
- The company may seek advice from the Australian Taxation Office/AusIndustry on whether the company qualifies as an ESIC
- But very advisable to have undertaken a thorough due diligence review first



## 3. Investors

# Investors - ESIC

- For investment in an assessed Early Stage Innovation Company the following benefits are available:
  - Tax Offset
    - 20% on the investment in the financial year subject to:
      - Maximum offset for a sophisticated investor - \$200,000
      - Maximum offset for a retail investor - \$10,000
- Investor Limits:
  - Sophisticated investor – no limit
  - Retail investor - \$50,000

# Investors – CGT Exemption

- Applies for original shareholders where shares disposed of between over 1 year and less than 10 years
- Sophisticated investor – no limit on the investment amount
- Retail investor – original investment in the financial year not to exceed \$50,000

# Need More Information?

- Please contact us for a discussion if you are:
  - An inventor, SME, entrepreneur – if you are interested in this process
  - An investor – if you are interested in reviewing companies' business plans





## 4. Crowd-Sourced Funding Equity Raising

# New Opportunity for SMEs

- 3 distinct opportunities to raise capital for SMEs:
  - Crowd-Sourced Funding
  - Early Stage Innovation Companies
  - S708 Capital Raisings
- Dream for many years by SMEs
- Starts 29<sup>th</sup> September 2017!

# New Opportunity for SMEs (cont'd...)

- Most companies will be small
- Pty Ltd companies have to convert to an Unlisted Public company

# New Opportunity for SMEs (cont'd...)

- Eligible unlisted public companies:
- Turnover under \$25M
- Value of gross assets under \$25M
- Can raise up to \$5M every 12 months

# New Opportunity for SMEs (cont'd...)

- 5 year exemption of onerous requirements:
  - Holding AGMs
  - Audit of accounts
  - Providing “paper” annual reports

# New Opportunity for SMEs (cont'd...)

- Audit exemption expires if the company raises over \$1M in equity
- “Gatekeepers” – CSF Intermediaries:
  - Financial Services License
  - Check CSF Offer Document
- Company must produce adequate documents to be able to satisfy the Intermediary and potential investors

# New Opportunity for SMEs (cont'd...)

- Some companies will become “big business”
- But the “fairy tale” will end unless there is strong discipline in the production of documents!

# New Opportunity for SMEs (cont'd...)

- Companies need to produce:
  - CSF Offer Document which will rely on work that accountants can do or coordinate
  - Market Research
  - Marketing Plan
  - Intellectual Property Strategy
  - Management Plan
  - Team Plan
  - Corporate Chart



# New Opportunity for SMEs (cont'd...)

- Research and Development Strategy
- Business Plan
- Budgets and Cashflow Forecasts
- Information Memorandum

# Crowd-Sourced Funding Determination Process

- Does the company meet:
  - Group turnover requirement?
  - Group assets requirement?
  - Disclosure requirement for company, directors, officers, managers?

# Crowd-Sourced Funding Determination Process

- Directors need an understanding of:
  - Intermediary's role, responsibility and powers
  - Communication channel
  - That all of the information submitted to the Intermediary is available to the “crowd”

# Proprietary Limited Companies and CSF

- The government has released an “Exposure Draft” on a proposed amendment which would enable Proprietary Limited companies to raise capital from Crowd-Sourced Funding
- If passed, not expected to be available until March/April 2018

# Crowd-Sourced Funding Investor Opportunities

- Sophisticated Investors – no limit on investment
- Retail Investors – maximum \$10,000 over 12 month period per company
- “5 business day cooling off period”

# Questions?

- Research and Development
- Early Stage Innovation Company
- ESIC Investor Tax Offset
- Crowd-Sourced Funding Equity Raising
- CSF Investor Opportunities

# Questions?

Want to have a discussion? – Please make an appointment

Thank you for attending