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Customer Information Guide

# EARLY STAGE VENTURE CAPITAL LIMITED PARTNERSHIPS (ESVCLPs)

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This guide will help with understanding the requirements of Early Stage Venture Capital Limited Partnerships ([ESVCLPs](#)).

If seeking ESVCLP **registration**, complete and submit the [online application form](#) and the supporting documents listed under [Applying](#) on the [ESVCLP web page](#). **Innovation and Science Australia's Innovation Investment Committee (the Committee)** will decide on the application. For assistance with an application, [contact us](#) or email [venturecapital@industry.gov.au](mailto:venturecapital@industry.gov.au).

Some provisions of the *Venture Capital Act 2002*, which enables the ESVCLP program, refer to “in the form approved by Innovation and Science Australia”. A [list](#) of those provisions and a description of the approved form for each is provided by Innovation and Science Australia.

Note: Terms shown in bold are first references to terms described in the [glossary](#) and link to that description.

## **1. ESVCLP overview**

The program aims to stimulate Australia's venture capital sector by helping fund managers attract pooled capital. Fund managers who plan to raise an ESVCLP of between \$10 million and \$200 million can apply to the Committee to register the partnership as an ESVCLP. An ESVCLP is a flow-through entity (it is not a taxing point). Its investors pay no tax on their share of returns (capital or income) when an ESVCLP disposes of an eligible investment. However, an investor's share of a loss arising from the disposal of an eligible investment is not deductible.

Broadly, an [eligible venture capital investment](#) is the acquisition by an ESVCLP of new shares or units in an eligible Australian business with total assets of not more than \$50 million. An ESVCLP is no longer required to divest an eligible venture capital investment when its total assets exceed \$250 million (although tax concessions are restricted from this threshold).

The program is enabled by the:

- *Venture Capital Act 2002* (VCA)
- *Income Tax Assessment Act 1936* and the *Income Tax Assessment Act 1997* (ITAA36 and ITAA97).

The program commenced on 21 June 2007 when the Tax Laws Amendment (2007 Measures No. 2) Bill 2007 – which amended the VCA and both the ITAA36 and the ITAA97 – received Royal Assent. It is jointly administered by the Department of Industry, Science, Energy and Resources and the Australian Taxation Office (ATO).

## 2. Registration as an ESVCLP

### 2.1 Innovation and Science Australia’s Innovation Investment Committee

The Committee, as a delegate of Innovation and Science Australia, oversees the program and decides registration applications based on the program legislation. The Committee is supported by AusIndustry – Industry Capability and Research Division, a division of the Department of Industry, Science, Energy and Resources.

### 2.2 Eligibility criteria [Divisions 9, 11 and 13 VCA]

A partnership must meet the following criteria to be eligible for registration as an ESVCLP.

Eligibility criteria	VCA reference
<p>It must:</p> <ul style="list-style-type: none"> <li>• be a limited partnership*</li> <li>• be established in Australia or a country with which Australia has a <a href="#">double tax agreement</a></li> </ul> <p>* Limited partnerships are established under state and territory laws. Most states and territories allow for the establishment of an <a href="#">incorporated limited partnership</a> for the purpose of registering as an ESVCLP. A limited partnership must also meet the relevant criteria as defined in s995-1(1) of the ITAA97.</p>	<p>s9-3(1)</p> <p>s9-3(1)(a)(i) or (ii)</p>
<ul style="list-style-type: none"> <li>• have a partnership agreement that: <ul style="list-style-type: none"> <li>○ remains in existence for not less than five years and not more than 15 years*</li> <li>○ requires partners to contribute capital when required</li> <li>○ prohibits the addition of new partners except as provided for in the agreement</li> <li>○ prohibits increases in <a href="#">committed capital</a> except as provided for in the agreement</li> <li>○ confers on a <a href="#">general partner</a> the right to require partners to contribute their committed capital to the partnership</li> </ul> </li> </ul>	<p>s9-3(1)(c),</p> <p>s11-1(2)(f)</p>

Eligibility criteria	VCA reference
<ul style="list-style-type: none"> <li>○ includes a plan that outlines its intended investment activities†</li> </ul> <p>* From the date the partnership was registered as a limited partnership or an incorporated limited partnership.</p> <p>† This plan must focus on early stage venture capital investments (s13–20(1)). If a partnership is registered as an ESVCLP, this becomes the <a href="#">approved investment plan</a> – see <a href="#">section 3</a>.</p>	
<ul style="list-style-type: none"> <li>● have a general partner(s) that: <ul style="list-style-type: none"> <li>○ is a resident of either Australia or a country with which Australia has a double tax agreement</li> <li>○ has access to appropriate venture capital management skills and resources to implement investment plan</li> </ul> </li> </ul>	<p>s9–3(1)(b)</p> <p>s13–1(1A)(d)</p>
<ul style="list-style-type: none"> <li>● have at least \$10 million* and not more than \$200 million committed capital</li> </ul> <p>*A partnership that does not satisfy the minimum capital requirement may be eligible for <a href="#">conditional registration</a> – see <a href="#">section 2.5.1</a></p>	<p>s9–3(1)(d)</p>
<ul style="list-style-type: none"> <li>● ensure no partner (investor) contributes more than 30% of the partnership’s committed capital unless approved by the Committee.* Banks, life insurance offices and widely held superfunds are exempt from this restriction. Foreign venture capital fund of funds are also exempt, provided they are widely held</li> </ul> <p>* See <a href="#">section 4.2</a></p>	<p>s9–3(1)(e),</p> <p>s9–3(4), s9–4</p>
<ul style="list-style-type: none"> <li>● not hold any investments that are not allowed by the VCA or are not in accordance with the partnership’s approved investment plan. The partnership can only hold <a href="#">debt interests</a> that are permitted loans</li> </ul>	<p>s9–3(1)(f), (g) and (k)</p>
<ul style="list-style-type: none"> <li>● only carry on activities related to making investments allowed by the VCA.</li> </ul>	<p>s9–3(1)(j)</p>



### 2.3 Applying for registration [Division 11 VCA]

Apply for ESVCLP registration using the [online application form](#). For assistance with an application, [contact us](#) or email [venturecapital@industry.gov.au](mailto:venturecapital@industry.gov.au).

Summary	VCA reference
Complete and submit the <a href="#">online application form</a> .	s11-1(1)
Can be lodged anytime, free of charge.	s11-1(1)
An application must include: <ul style="list-style-type: none"> <li>• a certificate of registration as a limited partnership or an incorporated limited partnership</li> <li>• partners' details</li> <li>• a signed eligible partnership agreement (including an investment plan)</li> <li>• the partnership's information memorandum or any public offer documents</li> <li>• CVs and time commitments of key people.</li> </ul>	s11-1(2)
The Committee can request additional information before deciding on an application for registration.	s11-10

### 2.4 Granting registration [Division 9, 11 and 13 VCA]

The Committee will grant registration if it considers the application satisfies the legislative requirements. Generally, the Committee can provide registration if it is satisfied the general partner:

- has the skills to operate an early stage venture capital partnership
- has access to deal flow and capital
- has an appropriate investment plan with an early stage focus.

Registration	VCA reference
The Committee has 60 days after receiving a complete application to decide whether to grant registration (can be extended by a further 60 days).*	s11-15

<b>Registration</b>	<b>VCA reference</b>
*A complete application is one that satisfies all the requirements of s11-1(2) of the VCA. If the application is incomplete it will not be considered. The 60-day timeframe does not start until all information and documents are received. If the last day to decide an application – the 60th day – falls on a Saturday, Sunday or public holiday, the decision can be made on the next business day.	
<p>Registration may be granted if the Committee is satisfied the partnership:</p> <ul style="list-style-type: none"> <li>• is an eligible limited partnership (see <a href="#">section 2.2</a>)</li> <li>• has an appropriate investment plan (see <a href="#">section 3</a>)</li> <li>• has access to the management expertise needed to implement its investment plan.</li> </ul>	s9-3, 13-20, s13-1(1A)(d)

## 2.5 Registration

### 2.5.1 Conditional Registration [s13-5(1A) VCA]

A partnership that does not meet all the requirements under s9-3 of the VCA, such as not having at least \$10 million committed capital, may be granted conditional registration. A partnership that has been conditionally registered must present evidence to satisfy the Committee that it is likely to gain registration within 24 months. Conditional registration lapses after 24 months if a partnership does not meet the registration requirements.

A conditionally registered ESVCLP may, in certain circumstances, make investments. However, the ESVCLP must gain registration before it realises any gains, for the tax exemption to apply. To gain registration, a further complete application must be submitted that demonstrates the partnership meets all the requirements for registration. An application for registration can be lodged at any time during the conditional registration period. However, it should be lodged no later than 60 days before the conditional registration lapses (that is, within 24 months after the conditional registration was granted).

If conditional registration of an ESVCLP lapses, it can reapply for registration. However, the application would need to address, to the Committee’s satisfaction, those matters that prevented the partnership gaining registration.

When advertising a conditionally registered ESVCLP, it is important not to misrepresent the ESVCLP as being registered. Any reference to ‘registered’ should clarify that registration is conditional. The following statement may be used when advertising an ESVCLP: “The ESVCLP is conditionally registered as an early stage venture capital limited partnership and further conditions will need to be met before being registered as an ESVCLP”.

## 2.5.2 Registration [s13-1(1A) VCA]

A partnership that meets the ESVCLP registration requirements can apply for registration at any time using the [online application form](#).

## 2.6 When registration is in force [s13-1, s13-5 and s13-10 VCA]

Generally, ESVCLP registration of a partnership comes into force on the day the Committee grants registration (under s13-1(1A)). However, if a partnership is conditionally registered (under s13-5(1A)), and then the Committee grants ESVCLP registration, it is taken to have come into effect:

- for the purposes of the ITAA97 (that is, the tax concession), on the day the partnership was granted conditional registration
- for the purposes of the ITAA36 (that is, the flow-through tax treatment):
  - if the partnership has only carried on activities related to becoming registered as an ESVCLP, on the day the partnership was established
  - otherwise, on the day on which conditional registration was granted.

An investor would become entitled to the tax concession when full registration is granted and would be eligible to claim the tax concession in the year the capital was contributed, via an amendment to their tax return.

## 2.7 Maintaining registration [Division 9 VCA]

ESVCLP registration is subject to a number of ongoing requirements. To maintain registration an ESVCLP must ensure it meets the:

- [investment registration requirements](#)
- other registration requirements
- reporting requirements.

Investment registration requirements [s17-1(1)(ab)]	VCA reference
Any of the following constitute a failure to meet the investment registration requirements: <ul style="list-style-type: none"><li>• a limited partner (and <a href="#">associates</a>) provides more than 30% of a partnership's committed capital without the Committee's prior approval. Widely held superfunds, banks and life insurance offices are exempt (see <a href="#">section 4.2</a>)</li></ul>	s9-3(1)(e)

<b>Investment registration requirements [s17-1(1)(ab)]</b>	<b>VCA reference</b>
<ul style="list-style-type: none"> <li>an ESVCLP holds an investment that is either not permitted under the legislation or does not accord with its approved investment plan</li> </ul>	s9-3(1)(f) and (g)
<ul style="list-style-type: none"> <li>an ESVCLP carries on activities other than those related to either making eligible investments or activities not in accordance with its approved investment plan</li> </ul>	s9-3(1)(j) and (h)
<ul style="list-style-type: none"> <li>an ESVCLP holds a debt interest that is not a permitted loan.</li> </ul>	s9-3(1)(k) and s9-10
<p>Note: If the Committee is satisfied that an ESVCLP has failed to meet an investment registration requirement, it will notify the ESVCLP in writing that it must remedy the failure. This must be within a reasonable period, but not exceeding six months. If the failure is not remedied within the stipulated period, the Committee must revoke the ESVCLP's registration. This decision is reviewable under Division 29 of the VCA.</p>	
<b>Other registration requirements [s17-5(1)(ab)]</b>	<b>VCA reference</b>
<p>Any of the following constitute a failure to meet the other registration requirements:</p> <ul style="list-style-type: none"> <li>the ESVCLP is no longer a partnership that satisfies the eligibility requirements of the VCA</li> </ul>	s9-3(1)(a),(b),(c)
<ul style="list-style-type: none"> <li>the ESVCLP has committed capital of less than \$10 million or more than \$200 million.</li> </ul> <p>Note: If the Committee is satisfied an ESVCLP has failed to meet one of the above requirements, it will advise the ESVCLP. The ESVCLP then has 60 days in which to remedy the contravention. An ESVCLP can apply to have this extended by a further 60 days. If the contravention is not remedied within the period set by the Committee, registration must be revoked. A decision to revoke under this provision is reviewable under Division 29 of the VCA.</p>	s9-3(1)(d)
<b>Reporting requirements [s17-10]</b>	<b>VCA reference</b>
<p>Any of the following constitute a failure to meet the requirements of Division 15, allowing the Committee to revoke registration:</p>	

Reporting requirements [s17–10]	VCA reference
<ul style="list-style-type: none"> <li>not submitting quarterly return* within one month of the end of each quarter</li> </ul>	s15–10
<ul style="list-style-type: none"> <li>not submitting annual return* within three months of the end of the financial year</li> </ul>	s15–1
<ul style="list-style-type: none"> <li>not providing further information about investments or disposals notified under s15-10</li> </ul>	s15–15
<ul style="list-style-type: none"> <li>not providing information the Committee considers necessary for the purpose of administering the VCA</li> </ul>	s15–20
<ul style="list-style-type: none"> <li>repeated breaches in relation to holding ineligible investments.</li> </ul> <p>*AusIndustry has a pro forma for each report that is emailed to the general partner at the appropriate time.</p> <p>Note: If the Committee revokes registration under this section, that decision is reviewable under Division 29 of the VCA.</p>	s9–3(1)(f)

## 2.8 Revoking registration [Division 17 VCA]

The Committee may revoke an ESVCLP’s registration:

- for failing an ‘investment registration requirement’ (see [section 2.7](#))
- for failing any ‘other registration requirements’ (see [section 2.7](#))
- at its discretion (see [section 2.7](#))
- at the fund manager’s request (see below).

Generally, if the Committee considers an ESVCLP does not meet the registration requirements, it must issue a notice advising the ESVCLP and inviting a response. If after considering the response the Committee is satisfied there is a contravention, it will direct the ESVCLP to rectify the contravention within a period determined in accordance with the VCA. If the contravention is not remedied within the set period, the Committee must revoke the ESVCLP’s registration.

<b>Application by the fund manager</b>	<b>VCA reference</b>
<p>Applications for revocation can be lodged at any time and the Committee will revoke registration as soon as practicable.</p> <p>Note: Conditional registration cannot be revoked.</p>	s17–25

## **2.9 Review of a decision [Division 29 VCA]**

Division 29 sets out those Committee decisions that are reviewable. Under this Division, an ESVCLP may ask the Committee to review certain decisions. If the Committee confirms its decision, the ESVCLP may then apply to the Administrative Appeals Tribunal to review the decision.

The following are reviewable under the VCA (not an exhaustive list). Decisions under:

- section 9–4, refusing to allow a partner’s (investor’s) committed capital in an ESVCLP to exceed 30% of the ESVCLP’s committed capital
- subsection 9–10(3), allowing, or refusing to allow, a longer period for the purposes of paragraph 9–10(1)(b) for repayment by an investee to the ESVCLP of a permitted loan
- section 13–1, refusing to register a limited partnership as an ESVCLP
- section 13–5, refusing to conditionally register a limited partnership as an ESVCLP
- section 17–1, 17–5 or 17–10, revoking a registration under Part 2
- subsection 17–1(2), determining a period within which investment registration requirements must be met
- section 25–5, determining a shorter period, or refusing to make such a determination (relates to the Australian nexus test for a company [s118–425 of the ITAA97] or a unit trust [s118–427(3) of the ITAA97])
- section 25–10, refusing to make a determination (relates to the Australian nexus test for a company [s118–425 of the ITAA97] or a unit trust [s118–427(3) of the ITAA97])
- section 25–15, refusing to make a determination (relates to a company’s primary activity [s118–425(3) and (13) of the ITAA97] or a unit trust’s primary activity [s118–427(4) and (14) of the ITAA97]).

### **3. Approved investment plan**

It is a requirement of registration that an ESVCLP operates in accordance with its approved investment plan.

#### **3.1 Approving an investment plan [s13-1(1A) and s13-20 VCA]**

The Committee will approve an investment plan if it considers it is appropriate. The Committee must take into account the extent to which the plan focuses on early stage venture capital, having regard to the VCA criteria for investee entities set out below. However, the Committee is not limited to these matters in deciding if it considers an investment plan is appropriate:

- stages of development
- cash flow levels
- levels of technology
- proportion of intellectual property to total assets
- levels of risk and return
- amount of tangible assets and collateral against which borrowings may be secured.

The Committee will also take into account:

- offer documents
- the legislative requirements for an ESVCLP making and holding investments
- whether the ESVCLP committed capital requirements will be met
- any additional matters specified in guidelines issued by the Committee.

Generally the Committee, in the context of this program, considers early stage to be a description of venture capital, which includes investment in businesses at the:

- pre-seed
- seed
- start-up
- early expansion stages of development.

#### **3.2 Variation of an approved investment plan [s13-15 VCA]**

An ESVCLP can ask the Committee to approve a new investment plan as a replacement for its approved investment plan. A request must state why the ESVCLP wants the plan

replaced. If the Committee is satisfied the replacement plan is appropriate, it will approve the replacement plan. That plan then becomes the ESVCLP's approved investment plan. As the approved investment plan is included in the partnership agreement, that agreement should also be amended, if necessary, to refer to the replacement approved investment plan. If the Committee does not consider the replacement plan appropriate, it will refuse the request and provide a written notice including a statement of reasons for its decision. The decision is not reviewable.

### **3.3 Operate in accordance with an approved investment plan [s9-3(1)(g) and (h) VCA]**

It is a requirement that an ESVCLP operates in accordance with its approved investment plan and that the investments it holds are consistent with that plan. Failure to do so is a breach of the investment registration requirements and will result in the Committee commencing proceedings to revoke the ESVCLP's registration.

### **3.4 Reporting on implementation of an approved investment plan [s15-17 VCA]**

An ESVCLP must report within three months after the end of each financial year on the implementation of its approved investment plan. The report must include descriptions of investments and disposals the ESVCLP made during the year. As the Committee is required to publish the reports it receives, an ESVCLP should ensure it complies with the VCA but does not reveal information it does not want in the public domain.

## **4. Capital raising and partnership size**

### **4.1 Minimum and maximum size [s9-3(1)(d) VCA]**

To be eligible for ESVCLP registration a partnership must have at least \$10 million and not more than \$200 million in committed capital. This requirement is ongoing.

Note: Conditional registration can be granted to a partnership that has yet to raise capital (see [section 2.5.1](#)).

### **4.2 Limit on amount an investor can contribute [9-3(1)(e), 9-3(4),(5) and 9-4 VCA]**

An investor (limited partner) cannot contribute more than 30% of an ESVCLP's committed capital unless the Committee otherwise approves. Banks, life insurance companies and [widely held complying superannuation funds](#) are exempt from this restriction. A foreign venture capital fund of funds is also allowed to hold more than 30% committed capital in an ESVCLP, provided the fund is widely held and the ultimate investors are eligible foreign investors.

An investor in an ESVCLP can apply to the Committee under Division 9-4 of the VCA for its committed capital to exceed 30% of the ESVCLP's committed capital. A Committee decision to refuse an application is reviewable under Division 29 of the VCA.



The Committee may, by legislative instrument, make principles about making these types of decisions. Any legislative instruments will be published on the [ESVCLP web page](#) and on the Federal Register of Legislation.

### **4.3 Committed capital [s118–445 ITAA97]**

Section 118–445 of the ITAA97 defines committed capital. To maintain ESVCLP registration, a limited partnership must have at least \$10 million and not more than \$200 million committed capital. A partner cannot contribute more than 30% of an ESVCLP’s committed capital (see [section 4.2](#)). Also, an investment cannot represent more than 30% of an ESVCLP’s committed capital [s118–425(1)(d) of the ITAA97].

### **4.4 Australian Financial Services Licence (AFSL)**

Please visit the [ASIC website](#) to determine whether the proposed ESVCLP structure requires an AFSL under the *Corporations Act 2001*.

## **5. Regulation of ESVCLP activities and investments**

### **5.1 ESVCLP activities [s9–3(1)(f) to (k) VCA]**

An ESVCLP can only carry on the business of being an ESVCLP (that is, being a venture capital partnership) and can only hold investments as provided for under the VCA.

Investments must accord with an ESVCLP’s approved investment plan and they must be either:

- an eligible venture capital investment
- permitted by s9–3(f)(ii) or (iii) of the VCA
- a debt interest that is a permitted loan.

### **5.2 Eligible investments [s118–425 or 427 and 428 ITAA97]**

For an ESVCLP investing in an entity (the investee entity), the entity meets the eligible venture capital investment requirements providing it satisfies either s118–425 (investment in a company) or s118–427 (investment in a unit trust), and s118–428 (additional investment requirements for ESVCLPs) of the ITAA97. The requirements include restrictions on the investments that an investee entity can hold or acquire. Essentially, the investee entity can only invest in other entities provided that after the investment, the investee entity controls the other entity and the other entity broadly satisfies the requirements to be an eligible venture capital investment. Following the investment, the investee entity must take into account the activities of the other entity when applying the [predominant activity](#) test for a six-month period from when the investment first occurs.

The eligible venture capital investment requirements have different timeframes. Some may apply at the time the investment is made, or for a certain period after the investment is made and some may be an ongoing requirement.

An ESVCLP cannot invest in an entity that exceeds the permitted entity value (total assets of \$50 million [s118–440 of the ITAA97]). That is, the ESVCLP should not invest until it has established that the entity does not have total assets of more than \$50 million.

An entity that is an eligible venture capital investment only requires an auditor to be appointed for an income year if:

- it is a public company or a large proprietary company within the meaning of the *Corporations Act 2001* for the financial year corresponding with that income year
- it is a unit trust and, if it was a company, it would have been a public company or a large proprietary company within the meaning of the *Corporations Act* for the financial year corresponding with that income year, or
- the value of the assets of the entity exceeds \$12.5 million.

If an entity has not and is not required to appoint an auditor, the value of the assets of the entity for certain purposes is the market value stated by the board or trustee of the entity, made in a statutory declaration (this is subject to integrity rules).

Below is an overview which should be read in conjunction with the relevant tax provisions.

Eligible investment	Requirements	ITAA97 reference
An investment in a business that: <ul style="list-style-type: none"> <li>• is located in Australia, including:               <ul style="list-style-type: none"> <li>○ 50% of its assets</li> <li>○ 50% of its staff</li> </ul> </li> </ul>	At the time of the investment and for at least 12 months after (The Committee can approve a variation. See <a href="#">section 5.2.6.</a> )	s118–425(2), s118–427(3)
<ul style="list-style-type: none"> <li>• is either a company or a unit trust</li> </ul>	At the time of the investment and ongoing	s118–425(1)(b), s118–427(1)(b)
<ul style="list-style-type: none"> <li>• has total assets of not more than \$50 million</li> </ul>	At the time of the investment	s118–440, s118–440(9)(a)
<ul style="list-style-type: none"> <li>• has a registered auditor</li> </ul>	By the end of the year of the initial investment	s118–425(5), s118–427(6)
<ul style="list-style-type: none"> <li>• has a predominant activity that is not:               <ul style="list-style-type: none"> <li>○ property development or land ownership</li> <li>○ finance*</li> </ul> </li> </ul>	At the time of the investment and ongoing (The Committee has some discretion. See <a href="#">section 5.2.7.</a> )	s118–425(3),(13), (13A) s118–427(4),(14), (14A) s118–432

Eligible investment	Requirements	ITAA97 reference
<ul style="list-style-type: none"> <li>○ insurance*</li> <li>○ construction</li> <li>○ making investments directed at deriving passive income*</li> </ul> <p>*From 1 January 2019, none of the following activities are ineligible activities:</p> <ul style="list-style-type: none"> <li>• developing technology for use in relation to one of the activities referred to above marked with an asterisk (*) (these technologies are referred to as financial technology or ‘fintech’)</li> <li>• an activity ancillary or incidental to developing such technology, or</li> <li>• an activity that is the subject of a finding that it is a substantially novel application of technology in force at the time the investment was made.</li> </ul> <p>Note: ESVCLPs intending to invest in fintech businesses should consider whether this is permitted under their approved investment plan or whether a request for the Committee to approve a replacement plan needs to be made. (See <a href="#">section 3.2.</a>)</p>		
<ul style="list-style-type: none"> <li>• does not invest the ESVCLP’s investment in another entity (there are exceptions)</li> </ul>	Ongoing	s118–425(4),(11), s118–427(5)
<ul style="list-style-type: none"> <li>• is not listed. There are exceptions in cases where an ESVCLP invested before listing.</li> </ul>	At the time of the investment and ongoing	s118–428(1)(a)
<b>The investment must also be:</b>		
<ul style="list-style-type: none"> <li>• <a href="#">at risk</a></li> </ul>	At the time of the investment and ongoing	s118–425(1)(a), s118–427(1)(a), s118–430
<ul style="list-style-type: none"> <li>• new shares or units, or options to acquire shares, units or convertible notes (that are not debt interests). In certain circumstances, pre-owned</li> </ul>	At the time of the investment	s118–428, s118–425(1)(b), s118–427(1)(b)

<b>The investment must also be:</b>		
shares or units are allowed. See <a href="#">section 5.2.1</a>		
<ul style="list-style-type: none"> <li>a total amount that is not more than 30% of the ESVCLP's committed capital</li> </ul>	At the time of the investment	s118-425(1)(d), s118-427(1)(d)
<ul style="list-style-type: none"> <li>held by the ESVCLP for at least 12 months</li> </ul>		s118-407(1)(d)(ii)
<ul style="list-style-type: none"> <li>made and disposed of while registered as an ESVCLP.</li> </ul>		s118-407(1)

The following can also qualify as eligible venture capital investments:

#### 5.2.1 Pre-owned shares or units [s118-428(1)(b) and (c), and s118-428(2) ITAA97]

An ESVCLP may acquire pre-owned shares or units in an eligible business if the ESVCLP:

- already holds an eligible venture capital investment in that business, or
- is acquiring an eligible venture capital investment at the same time.

The total value\* of an ESVCLP's investment in pre-owned shares or units cannot exceed 20% of the ESVCLP's committed capital.

\* Value is defined at s118-428(3) of the ITAA97.

#### 5.2.2 Listed shares or units [s118-428(1) ITAA97]

An ESVCLP can only acquire shares or units in a listed business if the ESVCLP made and holds an eligible venture capital investment in the business before it was listed.

#### 5.2.3 Convertible notes [s118-425(1)(b)(iii) and s118-425(9) and (15) ITAA97]

Convertible notes, other than convertible notes that are debt interests, qualify as an eligible venture capital investment. If the convertible note is a debt interest, it is not an eligible venture capital investment. However, it may be acquired if it qualifies as a permitted loan under s9-10 of the VCA (see [section 5.4](#)).

A SAFE (simple agreement for future equity) note is a convertible security that allows the investor to buy shares in a future equity round. To be an eligible venture capital investment, a [SAFE note](#) must have the characteristics of a convertible note and not be a debt interest.

Note: Division 974 of the ITAA97 sets out the tests for determining whether an interest is debt or equity.

#### 5.2.4 Investments in foreign resident holding companies [s118–435 ITAA97]

Where an investee (holding) company meets the ‘permitted entity value’ and listing requirements, it will be treated as meeting the other eligible venture capital investment requirements (such as residency, activity and auditor requirements) if it:

- is a resident of Canada, France, Germany, Japan, the United Kingdom or the United States
- beneficially owns all the shares in an Australian resident company (subsidiary) or all of the units in a unit trust, which satisfies the requirements of an eligible venture capital investment
- does not carry on any business other than to support the primary activity of the subsidiary company or trust.

However, if the subsidiary company ceases to be an Australian resident or the subsidiary trust ceases to carry on business in Australia at any time within 12 months after the day the first eligible venture capital investment in the holding company was made, the investment in the holding company will cease to be an eligible venture capital investment. Any further investments made in the company will not be eligible for exemption.

#### 5.2.5 Exception to location within Australia [s118–425(12A) and s118–427(13) ITAA97]

An ESVCLP can invest up to 20% of its committed capital in investments that would be eligible venture capital investments, except for not meeting the Australian location test for companies [s118–425(2)] or unit trusts [s118–427(3)]. These investments are treated as eligible venture capital investments.

In calculating the 20%, the total value of all other investments the entity owns is to be based on their value at the time the entity makes the new investment. For example, Fund 1 wants to purchase a new foreign investment worth \$2 million. However, it has \$100 million committed capital and other purchases (from several years ago) that are now worth \$12 million and \$8 million, so the new purchase would take the ESVCLP over the 20% limit.

Where the Committee has determined that the Australian location tests do not apply to an investment in a particular company (see [section 5.2.6](#)), that investment does not count toward the 20% limit.

#### 5.2.6 The Committee’s discretionary powers [Division 25 VCA and s118–432 ITAA97]

The Committee can make determinations and relax some of the requirements that relate to an eligible venture capital investment (specifically sections 118–425(2)(b), (3), (13), (14) and 118–427(3)(c), (4), (14), (15) of the ITAA97). These provisions relate to how closely an investee must be connected with Australia for it to be an eligible investment and its predominant activity. Generally, an investee must undertake more than 50% of its operations in Australia at the time of an investment and for at least 12 months after. It must also have an eligible predominant activity. The Committee may, upon application by an ESVCLP, relax these requirements. An application must be made in the approved form, which is specified on the [ESVCLP web page](#).

The Committee can also make public or private findings that an activity related to finance, insurance or making investments is a substantially novel application of technology (s118–432 of the ITAA97). The effect of such a finding is that the activity is excluded from being an ineligible activity (s118–425(13A)(c) and 118–427(14A)(c)), permitting an ESVCLP to invest in businesses engaged in substantially novel activities relating to fintech where the other requirements of an eligible venture capital investment are satisfied. For more information refer to the [Fintech private finding application guidance](#).

#### 5.2.7 Scrip for scrip investments [s118–245(8) and s118–427(9) ITAA97]

Where shares in another company are acquired in exchange for shares that, at the time of disposal, were an eligible venture capital investment (that is, a scrip for scrip exchange), the replacement shares will be treated as an eligible venture capital investment even if the company does not satisfy the requirements. However, if the company in which the replacement shares are held does not actually satisfy the requirements for a venture capital investee company, any shares acquired from a further scrip for scrip sale will not be treated as an eligible venture capital investment.

The replacement shares acquired under a scrip for scrip sale will only qualify as an eligible venture capital investment if the ESVCLP disposes of *all* of its shares in the original investee company in return for shares in the other company.

### 5.3 Investments permitted by s9–3(f)(ii) or (iii) VCA

These provisions apply when at the time an ESVCLP makes a follow-on investment in an entity it already holds an eligible venture capital investment in:

- the entity is no longer an Australian resident and the follow-on investment in the entity takes the partnership’s committed capital in the ESVCLP above the 20% cap allowed in foreign investments – see [section 5.2.5](#), or
- the entity exceeds the \$50 million assets limit.

These follow-on investments do not qualify as eligible venture capital investments but can still be made by an ESVCLP. However, gains on these follow-on investments will be taxed in the hands of investors.

### 5.4 Permitted loans [s9–10 VCA]

An ESVCLP can only hold a debt interest if it is a permitted loan as defined at s9–10 of the VCA. Generally, an ESVCLP can lend money to a company or unit trust once it holds an eligible venture capital investment in that entity and that investment is at least 10% of the investee.

An ESVCLP may also lend money to a business where it does not hold an investment if the loan is repaid within six months. If there are exceptional circumstances, the Committee may extend the repayment period [s9–10(1)(b), (2) and (3)].

Note: Division 974 of the ITAA97 sets out the tests for determining whether an interest is debt or equity.

## **6. Managing an ESVCLP**

### **6.1 General partner**

The general partner is responsible for managing the operation of an ESVCLP. Specifically, it is the body that is responsible for ensuring the ESVCLP holds only permitted investments and operates in accordance with the relevant legislation. The general partner should be a management team that consists of individuals with skills and experience relevant to managing an early stage venture capital partnership. The general partner should also have access to deal flow and capital.

### **6.2 Venture capital management partnerships [s94D(3) ITAA36]**

A venture capital management partnership (VCMP) is a limited partnership that:

- is a general partner of one or more:
  - ESVCLPs
  - Venture Capital Limited Partnerships (VCLPs)
  - Australian Venture Capital Fund of Funds (AFOF)
- only carries on activities that relate to being a general partner.

A limited partnership ceases to be a VCMP if it ceases to meet these requirements.

The general partner of an ESVCLP or a limited partner in a VCMP who becomes entitled to receive a payment of a 'carried interest' may have that payment taxed as a capital gain, which may be subject to concessional taxation. For the carried interest to qualify as a discount capital gain, the general partner must have entered into the partnership agreement under which the gain arose at least 12 months previously, and must meet the other requirements for the discount.

### **6.3 Reporting to the Committee [Division 15 VCA]**

An ESVCLP must:

- report on its activities within one month of the end of each quarter
- provide an annual return within three months of the end of the financial year
- provide a report to the Committee annually on its progress in implementing its approved investment plan.

The Committee will monitor compliance through examining relevant documents, including an ESVCLP's quarterly and annual returns. The Committee may also ask for additional information it considers necessary for administering the program.

Compliance assessments are also undertaken by the ATO, which receives copies of all ESVCLP reports submitted to the Committee. The ATO may undertake risk assessment activities to ensure compliance with the legislation it administers. The Australian tax system works on self-assessment.

## **6.4 Statement of expectation**

The Committee has issued an [Expectation and Compliance Statement](#), which has been published on the [ESVCLP web page](#). The statement outlines what the Committee expects from an ESVCLP.

## **7. Taxation [sourced from the ATO]**

### **7.1 Description**

The program's tax benefits operate by:

- treating ESVCLPs as ordinary partnerships, or 'flow-through' vehicles, for tax purposes
- exempting all partners of an ESVCLP from tax on their share of the income and gains derived from, or from disposal of, eligible early stage venture capital investments
- giving limited partners a non-refundable carry forward tax offset of up to 10% of their eligible contributions
- taking general partners' interests to be held on capital account rather than on revenue account.

A limited partner contributing to an ESVCLP that becomes unconditionally registered on or after 7 December 2015 will be entitled to a non-refundable carry forward tax offset equal to 10% of their contributions to the partnership made on, after and, under the transition rules, before 1 July 2016. The 10% tax offset will not be available for investors in ESVCLPs that were unconditionally registered as at 7 December 2015.

Members of trusts or partnerships that are limited partners of an ESVCLP will also be entitled to the offset on a flow-through basis.

### **7.2 Capital gains and losses**

A partner's share of capital gains and losses arising in relation to an eligible venture capital investment is exempt from income tax if it meets the following conditions:

- the entity is a partner in a limited partnership that was unconditionally registered as an ESVCLP when it made the investment
- if the partner is a general partner, the general partner is either an Australian resident or a resident of a foreign country in respect of which a double tax agreement (as defined in Part X of the ITAA36) with Australia is in force



- the capital gains tax (CGT) event relates to an eligible venture capital investment that met all of the additional investment requirements for investments by ESVCLPs
- at the time of the CGT event, the ESVCLP:
  - owned the investment and had done so for at least 12 months
  - was unconditionally registered
  - satisfied the registration requirements of an ESVCLP under the VCA, other than the investment registration requirements.

### **7.3 Income derived from eligible venture capital investment**

A tax exemption is also provided for an entity's share of any income derived from an eligible venture capital investment, such as a dividend, if the following conditions are satisfied:

- the entity is a partner in a limited partnership that was unconditionally registered as an ESVCLP when it made the investment
- if the partner is a general partner, the general partner is either an Australian resident or a resident of a foreign country in respect of which a double tax agreement (as defined in Part X of the ITAA36) with Australia is in force
- when the income was derived, the ESVCLP owned the investment and was unconditionally registered.

There is no exemption from income tax to the extent that the income is a payment of a general partner's 'carried interest' in an ESVCLP.

### **7.4 Gain or profit from disposal of eligible investments**

An entity's share of any gain or profit made from the disposal or other realisation of an eligible venture capital investment is exempt from income tax if:

- it is made by an ESVCLP that is unconditionally registered
- it would be eligible for the above exemption in relation to capital gains if the disposal or realisation was a CGT event.

A partner's share of a loss arising from the disposal of an eligible venture capital investment by an ESVCLP is not deductible.

### **7.5 Carried interest**

The general partner of an ESVCLP or a limited partner in a VCMP (see [section 6.2](#)) that becomes entitled to receive a payment of a 'carried interest' will have that payment taxed as a capital gain. For the carried interest to qualify as a discount capital gain, the general partner

must have entered into the partnership agreement under which the gain arose at least 12 months previously, and must meet the other requirements for the discount.

## 8. Monitoring and sanctions

### 8.1 Powers to direct

If the Committee is satisfied that an ESVCLP has contravened the VCA, it must direct the ESVCLP to remedy the contravention within a period of time. The period will depend on the nature of the contravention (see [section 2.7](#)). The Committee must revoke the registration of an ESVCLP that fails to remedy a contravention.

### 8.2 Powers to monitor

The Committee is required to monitor an ESVCLP's activities to ensure they continue to operate in accordance with the relevant legislation and meet the registration requirements of an ESVCLP. This is generally undertaken through reviewing ESVCLP returns (quarterly and annual). Copies of these returns are routinely provided to the ATO.

### 8.3 Annual report

Innovation and Science Australia reports on the ESVCLP program in its annual report to the Minister for Industry, Innovation and Science.

## 9. Glossary of terms

Summary	Term
<b>Approved investment plan</b>	A plan approved by the Committee under s13- 1(1A)(c) or s13-15(5) of the VCA
<b>Associate</b>	Section 995-1 of the ITAA97
<b>At risk</b>	Section 118-430 of the ITAA97
<b>Committed capital</b>	Section 118-445 of the ITAA97
<b>Conditional registration</b>	Registration granted under s13-5(1A) of the VCA
<b>Debt interest</b>	Division 974 of the ITAA97 sets out the tests for determining whether an interest is debt or equity
<b>Double tax agreement</b>	See <a href="#">ATO</a> site
<b>Eligible venture capital investment</b>	Sections 118-425, 118-427 and 118-428 of the ITAA97

<b>Summary</b>	<b>Term</b>
<b>ESVCLP</b>	Early Stage Venture Capital Limited Partnership registered under Part 2 of the VCA
<b>General partner</b>	A fund manager responsible for identifying and making investments, and whose liability in relation to the ESVCLP is not limited. See s995–1 of the ITAA97
<b>Incorporated limited partnership</b>	A separate legal entity that may sue or be sued in its firm name. These are special purpose, designed for use as venture capital partnerships under both the ESVCLP and VCLP programs
<b>Innovation and Science Australia</b>	A body established under the <i>Industry Research and Development Act 1986</i> (IR&D Act)
<b>Innovation Investment Committee</b>	A committee of Innovation and Science Australia appointed under the IR&D Act
<b>Investment registration requirements</b>	Subsection 9–3(2) of the VCA
<b>ITAA36 and ITAA97</b>	The <i>Income Tax Assessment Act 1936</i> and the <i>Income Tax Assessment Act 1997</i>
<b>Predominant activity</b>	Subsections 118–425(3) and 118–427(4) of the ITAA97
<b>Registration</b>	Registration under s13–1(1A) of the VCA
<b>The Committee</b>	Innovation Investment Committee
<b>VCA</b>	The <i>Venture Capital Act 2002</i>
<b>Widely held complying superannuation fund</b>	Within the meaning of s4A of the <i>Pooled Development Funds Act 1992</i>

## 10. For more information

For further information, visit the [ESVCLP web page](#) or contact AusIndustry on:

**Email:** [VentureCapital@industry.gov.au](mailto:VentureCapital@industry.gov.au)

**Phone:** 13 28 46