

Innovation and Science Australia

Information Paper

Innovation Investment Committee

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Exercise of discretion under section 9-4 (1) of the Venture Capital Act 2002 to allow a partner's committed capital in an Early Stage Venture Capital Limited Partnership to exceed 30 per cent of the Partnership's committed capital.

Purpose

This paper explains the approach Innovation and Science Australia (ISA) will take in considering whether, on the application of a partner in an Early Stage Venture Capital Limited Partnership (ESVCLP), to make a decision under section 9-4 (1) of the *Venture Capital Act 2002* (the Act) to allow the partner's committed capital in the partnership to exceed 30 per cent of the partnership's committed capital.

Policy intent

Section 9-4 (1) provides:

Innovation and Science Australia may, on the application of a partner of a partnership, make a decision allowing the partner's committed capital in the partnership to exceed 30% of the partnership's committed capital.

In considering whether to exercise its discretion under section 9-4(1) ISA will have regard to the policy intent of the ESVCLP program. The objective of the program is to encourage venture capital investment in early stage start-up and expanding businesses with high growth potential. To facilitate this the ESVCLP program provides a pooled investment vehicle with flow-through tax treatment and a complete tax exemption for income, both revenue and capital, received by domestic and foreign partners. The program also aims to enhance the development of venture capital investment and fund management skills.

To ensure the pooled character of the investment vehicle, the Act requires that no partner's share in an ESVCLP shall exceed 30 per cent of the ESVCLP's committed capital (s9-3(1)(e) of the Act). This is subject only to the list of entities exempt from the provision (see section 9-3(5)) and ISA's discretion to exempt a partner from the 30 per cent cap.

The purpose of the 30 per cent cap on committed capital is to ensure a spread of investors in the fund and to assist in building a broad cohort of investors in the early stage venture capital sector.

The following are examples of situations where ISA may exercise its discretion to allow a partner to commit more than 30 per cent of an ESVCLP's committed capital.

Exempt entities investing through an intermediate entity

An entity that falls within one of the categories listed in section 9-3(5) of the Act is exempt from the 30 per cent cap if investing into an ESVCLP directly. If the same entity invests indirectly into an ESVCLP through an intermediate entity, the intermediate entity will be subject to the cap. However, ISA may make a decision under section 9-4(1) to exempt an intermediate entity where the investors in that entity are comprised only of entities exempt by section 9-3(5).

For example, a widely-held complying superannuation fund within the meaning of section 4A of the *Pooled Development Funds Act 1992* is one of the entities listed in section 9-3 (5) of the Act. Therefore, when investing into an ESVCLP directly the 30 per cent cap will not apply to the superannuation fund. However, where it is the practice of a complying fund to make its investments indirectly through a pooled superannuation trust (PST), the PST will be subject to the cap. In this situation ISA may grant the PST an exemption from the cap so that the superannuation fund is placed in the same position it would have been in if investing directly into the ESVCLP.

ISA may require an applicant in these circumstances to satisfy it that the PST will not in the future accept additional investors other than widely-held complying superannuation funds.

Where exemption is appropriate to facilitate the achievement of the objectives of another government program or government policy, where those objectives align substantially with the objectives of the ESVCLP program

This situation arises where fund managers use ESVCLPs for making investments under Australian Government co-investment programs that involve the Australian Government investing alongside private investors in the fund. These co-investment programs typically require matching capital commitments to the effect that the Australian Government commits more than 30 per cent of a fund's capital. If no exemption was provided the Australian Government's share of committed capital would preclude registration of the fund as an ESVCLP by reason of section 9-3(1)(e) of the Act. This may deter some investors and hinder the achievement of the objectives of these Australian Government programs.

Australian venture capital fund of funds

Where an exemption is sought for an Australian venture capital fund of funds (AFOF) to hold more than 30 per cent of an ESVCLP's committed capital ISA will consider whether the AFOF is widely-held and that there is no significant risk that the AFOF will cease to be widely-held. ISA will consider an AFOF to be widely-held if it meets the definition of 'widely-held' in section 842-230(2) *Income Tax Assessment Act 1997*. However, an investor in the AFOF falling within one of the categories of exempt entities listed in section 9-3(5) shall be excluded from consideration in determining whether the AFOF satisfies the widely-held test.

General considerations for applicants

The examples provided do not confer an automatic exemption to the requirement of section 9-3(1)(e) of the Act. Only entities in the categories listed in section 9-3(5) are exempt. Otherwise an exemption must be sought by application to ISA.



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A request for an exemption from the 30 per cent cap should explain the reasons the applicant relies on to justify the exercise of the discretion by ISA in the particular circumstances of the ESVCLP. The application should address:

- a) how the ESVCLP objective to encourage venture capital investment in early stage and expanding Australian companies with high growth potential can only be achieved by the grant of an exemption;
- b) the extent to which the applicant's proposal will maintain the character of a pooled investment fund;
- c) how the exemption (and any conditions the applicant seeks to have attached to the exemption) will cohere with the overall scheme of the Act, be consistent with the purpose of the Act and not have the effect of supplementing the scheme in a manner inconsistent with it or be inconsistent with the express provisions of the Act; and/or
- d) the extent to which the exemption request will facilitate the achievement of objectives of another government policy or program. The establishment of the ESVCLP and the exemption request must be directly related to a specific Australian Government program.

ISA decisions

Where ISA grants an exemption under section 9-4(1) the 30 per cent cap ceases to apply to that partner's committed capital. ISA will not substitute an alternative cap.

However, ISA may attach other conditions when making a decision if it considers this is appropriate in order to maintain alignment with the policy objectives of the ESVCLP program. Conditions may be attached at the request of an applicant, or on ISA's own motion. By way of example, ISA may stipulate that the exemption will have effect for a limited period of time only. In this case the partner's share of committed capital in the partnership must comply with the 30 per cent cap from the expiry of the time limit set.

This guidance may be updated from time to time.