

Information for Early Stage Investors

EARLY STAGE INNOVATION COMPANY

Tailored Superannuation Solution Ltd has provided certain information to the Commissioner that details how it satisfies the requirements to be an Early Stage Innovation Company (ESIC) for the period 20 July 2016 to 30 June 2017. Potential investors that are seeking to be eligible for the early stage tax incentives should ensure the shares are issued by the company during this period.

The company has obtained a ruling issued by the Commissioner. The ruling is only about how the tax law applies to the company based upon the facts and information that the company has provided to the Commissioner.

INVESTOR REQUIREMENTS

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.

Consequently, you should make enquiries to confirm that there has been no change in the company's activities subsequent to 26 May 2017 (the date this private ruling issued) that could lead to a different outcome under the tests.

You should also consider whether you are eligible as an investor at, and immediately after, the time the company issues shares to you. Information for investor eligibility is available on www.ato.gov.au – search for “tax incentives for early stage investors”.

NO GUARANTEE OF COMMERCIAL SUCCESS

The Commissioner **does not** sanction or guarantee this investment. Further, the Commissioner gives no assurance that the company is commercially viable or that the company will develop into a successful innovative company.

Potential investors must form their own view about the commercial and financial viability of the company. The Commissioner recommends a financial (or other) adviser be consulted for such information.

DISCLAIMER

The Commissioner and any officer authorised to produce tax rulings cannot be held responsible for any financial loss that occurs in relation to shares in an ESIC. You should note that investors that are eligible for the early stage tax incentives must disregard any capital loss made from any CGT event happening in relation to a share in an ESIC if the investor held the share continuously since its issue and the CGT event happens within 10 years of the issue date.

ATO Reference:

Authorisation Number: 1051229697186



Edited version of your private ruling

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This edited version of your ruling will be published in the public register of private binding rulings after 28 days from the issue date of the ruling. The attached private rulings fact sheet has more information.

Please check this edited version to be sure that there are no details remaining that you think may allow you to be identified. If you have any concerns about this ruling you wish to discuss, you will find our contact details in the fact sheet.

Ruling

Subject: Early Stage Innovation Company

Question 1

Does the Company meet the criteria of an Early Stage Innovation Company (ESIC) under subsection 360-40(1) of the *Income Tax Assessment Act 1997* (ITAA 1997)?

Answer

Yes

This ruling applies for the following periods:

Year ending 30 June 2017

The scheme commences on:

July 2017

Relevant facts and circumstances

1. In 2010 an entity was established to hold the patent licence for the purpose of developing an innovative product.
2. The Company was incorporated in Australia in July 2016 as a public company for the purpose of being a stable reputable counterparty that develops and issues the innovation application sub-licences. Its equity interests are not listed for quotation in the official list of any stock exchange.
3. The Company has five reputable persons on its Board of Directors.
4. The patent for the innovation has been transferred subject to a Deed of Novation to the Company.
5. The Company has no subsidiaries and has no expenses or income in the previous income year, i.e. the year ended 30 June 2016 as it was not yet incorporated.
6. The Company is currently developing the innovation, a product not presently available in the marketplace.

7. The Company's primary goal is to establish itself as a profitable enterprise by sub-licensing the innovation.
8. The Company has an addressable market.

Commercialisation strategy

9. The Company has released Prototype v1.0 and completed client meetings with initial results positively received leading to beta clients
10. The Company has an acceptable business plan incorporated in its public offer document.
11. The Company is seeking to raise funds through its current public offering. Subject to the Minimum Subscription Requirement being attained, the Company plans to apply the funds raised to continue progress made with current beta clients and other interested parties.

Relevant legislative provisions

Income Tax Assessment Act 1997 Subdivision 360-A

Income Tax Assessment Act 1997 section 360-40

Income Tax Assessment Act 1997 section 360-45

Reasons for decision

Qualifying Early Stage Innovation Company

12. Subsection 360-40(1) outlines the criteria required for a company to qualify as an Early Stage Innovation Company (ESIC) at a particular time in an income year. This time is referred to as the test time. The criteria are based on a series of tests to identify if the company is at an early stage of its development and it is developing new or significantly improved innovations to generate an economic return.

'The early stage test'

13. The early stage test requirements are outlined in detail within paragraphs 360-40(1)(a) to (d).

Incorporation or Registration – paragraph 360-40(1)(a)

14. To meet the requirement in paragraph 360-40(1)(a), at a particular time (the test time) in an income year (the current year) the company must have been either:
 - iv. incorporated in Australia within the last three income years (the latest being the current year); or
 - v. incorporated in Australia within the last six income years (the latest being the current year), and across the last three of those income years the company and its 100% subsidiaries incurred total expenses of \$1 million or less; or
 - vi. registered in the Australian Business Register (ABR) within the last three income years (the latest being the current year).

15. The term 'current year' is defined in subsection 360-40(1) with reference to the 'test time'; the 'current year' being the income year in which the company issues shares to the investor.
16. A company that does not meet any of these conditions will not qualify as an ESIC.

Total expenses - paragraph 360-40(1)(b)

17. To meet the requirement in paragraph 360-40(1)(b), the company and its 100% subsidiaries must have incurred total expenses of \$1 million or less in the income year before the current year.

Assessable income - paragraph 360-40(1)(c)

18. To meet the requirement in paragraph 360-40(1)(c), the company and its 100% subsidiaries must have derived total assessable income of \$200,000 or less in the income year before the current year.

No stock exchange listing - paragraph 360-40(1)(d)

19. To meet the requirement in paragraph 360-40(1)(d), the company must not be listed on any stock exchange in Australia or a foreign country.

Innovation tests

20. If the company satisfies the early stage test, the company must also satisfy one of two innovation tests: the objective (100 point) test or the principles-based test.

'100 point test' – paragraph 360-40(1)(e) and section 360-45

21. To satisfy the 100 point test the company must obtain at least 100 points by meeting the innovation criteria in the table within section 360-45. The criteria are tested at a time immediately after the relevant shares are issued. If a company satisfies this test it does not need to satisfy the principles-based test.

'Principles-based test' – subparagraphs 360-40(1)(e)(i) to (iv)

22. To satisfy the principles-based test, the company must meet five requirements in paragraph 360-40(1)(e). This is tested at a time immediately after the relevant new shares are issued to the investor.
23. The company can demonstrate that it meets each requirement through existing documentation such as a business plan, commercialisation strategy, competition analysis or other company documents. The company must be able to show that tangible steps have been or will be taken in relation to each of the requirements.
24. The five requirements of the principles-based test, as outlined in paragraph 360-40(1)(e) are:
 - vi. the company must be genuinely focused on developing one or more new or significantly improved innovations for commercialisation
 - vii. the business relating to that innovation must have a high growth potential
 - viii. the company must demonstrate that it has the potential to be able to successfully scale up the business relating to the innovation
 - ix. 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, and

- x. the company must demonstrate that it has the potential to be able to have competitive advantages for that business.

Developing new or significantly improved innovations for commercialisation

25. For the purposes of Subdivision 360-A, the Explanatory Memorandum to the Tax Laws Amendment (Tax Incentives for Innovation) Bill 2016 ('EM') provides the following at paragraph 1.76 in relation to the definition of innovation:

"Implicit in the definition of innovation is the requirement that the company is developing a new or significantly improved type of innovation such as a product, process, service, marketing or organisational method. This list of various types of innovations provides flexibility for innovation companies and is adaptable to current and future innovations. The Oslo Manual, published by the Organisation for Economic Co-operation and Development (OECD) provides a description of these different types of innovations..."³

- 26. The innovation being developed by the company must either be new or significantly improved for an applicable addressable market. The company's addressable market is the revenue opportunity or market demand arising from the innovation or the related business. The addressable market must be objective and realistic.
- 27. Improvements must be significant in nature to meet this requirement. Customising existing products or minor changes resulting from software updates, pricing strategies or seasonal changes are examples of improvements that would not be considered significant.
- 28. The OECD Oslo Manual defines innovations as significant changes, with the intention of distinguishing significant changes from routine minor changes. However, it is important to recognise that an innovation can also consist of a series of smaller incremental changes that together constitute a significant change.⁴
- 29. In discussing services innovation activity, paragraph 111 of the OECD Oslo Manual states,

"Innovation activity in services also tends to be a continuous process, consisting of a series of incremental changes in products and processes. This may occasionally complicate the identification of innovations in services in terms of single events, i.e. as the implementation of a significant change in products, processes or other methods."
- 30. The OECD Oslo Manual, in relation to defining innovative services, states at paragraph 161 that "innovations in services can include significant improvements in how they are provided (for example, in terms of their efficiency or speed), the addition of new functions or characteristics to existing services, or the introduction of entirely new services."
- 31. The company must be genuinely focused on developing the innovation for a commercial purpose in order to generate economic value and revenue for the company. This requirement draws the distinction between simply having an idea and commercialising an idea.
- 32. '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.

³ See Explanatory Memorandum to the Tax Laws Amendment (Tax Incentives for Innovation) Bill 2016, paragraph 1.76.

⁴ OECD Oslo Manual, paragraph 124 and paragraph 151.

High growth potential

33. The company must be able to demonstrate that it has the potential for high growth within a broad addressable market. This refers to the company's ability to rapidly expand its business. Companies that are limited to supplying local customers will not meet this requirement.

Scalability

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

Broader than local market

35. The company must be able to demonstrate that it has the potential to address a market that is broader than a local city, area or region. The company does not need to have a serviceable market at a national, multinational or global scale at the test time. However, it does need to show that the business is capable of addressing a market that is broader than a local market and that the business can be adapted to a broader scale in the future.

Competitive advantages

36. The company must be able to demonstrate that it has the potential to have competitive advantages, such as a cost or differential advantage over its competitors which are sustainable for the business as it expands. The company can analyse what competitors in the market offer, and consider whether the company has a differentiating advantage that would allow it to outperform these competitors.

Application to your circumstances

Test time

37. For the purposes of this ruling, the test time for determining if 'The Company' is a qualifying ESIC will be a particular date during the income year ending 30 June 2017.

Current year

38. For the purposes of subsection 360-40(1), the current year will be the year ending 30 June 2017 (the 2017 income year). For clarity, in relation to particular requirements within subsection 360-40(1), the last three income years will include the years ending 30 June 2017, 2016 and 2015, and the income year before the current year will be the year ending 30 June 2016 (the 2016 income year).

Early stage test

Incorporation or Registration – paragraph 360-40(1)(a)

39. As the Company was incorporated in July 2016, which is within the last 3 income years, subparagraph 360-40(1)(a)(i) is satisfied.

Total expenses – paragraph 360-40(1)(b)

40. As the Company had nil expenses in the prior income year, it is less than \$1 million, and paragraph 360-40(1)(b) is satisfied.

Assessable income – paragraph 360-40(1)(c)

41. As the Company's assessable income for the prior income year was nil, it is less than \$200,000 and paragraph 360-40(1)(c) is satisfied.

No stock exchange listing – paragraph 360-40(1)(d)

42. As Company is a public company but it is not listed on any stock exchange in Australia or a foreign country, subparagraph 360-40(1)(a)(d) is satisfied.

Conclusion on early stage test

43. The Company will satisfy the early stage test for the entire 2017 income year, as each of the requirements within paragraphs 360-40(1)(a) to (d) have been satisfied.

Principles based test

Developing new or significantly improved innovations for commercialisation – subparagraph 360-40(1)(e)(i)

44. The Company is developing a new innovation for commercialisation

Genuinely focussed on developing for commercialisation – subparagraph 360-40(1)(e)(i)

45. Since the Deed of Novation transferring ownership of the innovation to the Company, it has continued the development of the innovation.

46. The Company's Offer document outlined the actions taken to date to develop the innovation and the next marketing steps.

47. The timeline submitted provides that the Company expects to implement the innovation in the first market within the 18 months implementation timetable.

Conclusion on subparagraph 360-40(1)(e)(i)

48. The Company is genuinely focussed on developing the innovation for a commercial purpose. The innovation will be a significantly improved product compared to existing products.

49. Therefore, subparagraph 360-40(1)(e)(i) will be satisfied for the income year ending 30 June 2017 or the date when the innovation has been fully developed, whichever occurs earliest. Once the innovation has been fully developed, The Company will no longer be 'developing' the product for commercialisation and subparagraph 360-40(1)(e)(i) will no longer be satisfied.

High growth potential – subparagraph 360-40(1)(e)(ii)

50. The innovation is expected to appeal to entities in its specific industry in Australia.

51. Through its commercialisation / marketing strategy, the Company hopes to initially foster widespread use of its product.

52. The Company will make their revenue through establishment fees and sub-licensing fees from users of the innovation and by expense reimbursements by customers of certain out of pocket expenses incurred by the Company.

53. Therefore, subparagraph 360-40(1)(e)(ii) will be satisfied.

Scalability – subparagraph 360-40(1)(e)(iii)

54. The Company's business model provided illustrates the increase in projected sales.
55. Given that the innovation will be available to all entities in its industry in Australia, it is expected that the Company has the potential to successfully scale up its business.
56. Potential revenue ranges have been calculated.
57. The operating leverage affords the Company the potential to successfully scale up its business. Therefore, subparagraph 360-40(1)(e)(iii) will be satisfied.

Broader than local market- subparagraph 360-40(1)(e)(iv)

58. The Company has demonstrated its innovation has the potential to address a broader market than just the local market, as it intends to market its product to all available customers throughout Australia. Therefore, subparagraph 360-40(1)(e)(iv) will be satisfied.

Competitive advantages – subparagraph 360-40(1)(e)(v)

59. The Company has differentiating features which may give it a competitive advantage:
60. Being the first of such the innovation has the first mover advantage. The Company has demonstrated the potential for the innovation to have competitive advantages within the community, satisfying subparagraph 360-40(1)(e)(v).

Conclusion on principles test

61. The Company satisfies the principles based test as it satisfies the requirements within subparagraphs 360-40(1)(e)(i) to (v) for the year ending 30 June 2017 or the date when the innovation has been fully developed and is ready for sale, whichever occurs earlier.

Conclusion

62. The Company meets the eligibility criteria of an ESIC under section 360-40 for the earlier of the year ending 30 June 2017 or the date when the innovation has been fully developed and is ready for sale, whichever occurs earlier.

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