



Venture Capital Subsidies in Australia

VCLPs

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VC investment in Australia

- Growing strongly
- 2005 VC Investment: AU\$11.1 billion
 - AU\$6.1 billion actively invested
 - Increase of 20% on previous year
 - AU\$5.1 billion yet to be drawn down
- % of GDP in OECD comparison
 - Aus: 0.12% of GDP
 - OECD average: 0.26% of GDP
 - US: about 0.55% of GDP



Analysing VC subsidies

- Types of subsidy
 - “front end” concessions
 - Point of entry to VC investments
 - “back-end” concessions
 - Exit (realisation) from investments
- Entity reform
 - Limited liability entities
 - Flow through tax treatment
 - Carryover/use of losses



Aus government incentives for VC

- Direct expenditures
 - Government grant programs - Commercial Ready, R&D start, COMET
 - Government investment funds – Innovation Investment Fund, Pre-Seed Fund
 - Small business entrepreneurship program
- Tax
 - Discount CGT rate and CGT small bus concessions (?) and scrip rollovers
 - Pooled development funds (PDF)
 - Venture Capital Limited Partnership (VCLP)



Current policy environment

- Current Budget cycle – May 2006
- Reports not yet released to public
 - Venture Capital Review
 - PDF Board - internal reports
 - Howard Partners report on economic impact of investments over last 10 years
- AVCAL
 - Active lobbying by VC managers
 - Growth-oriented SMEs are not DIRECTLY represented by an effective industry body



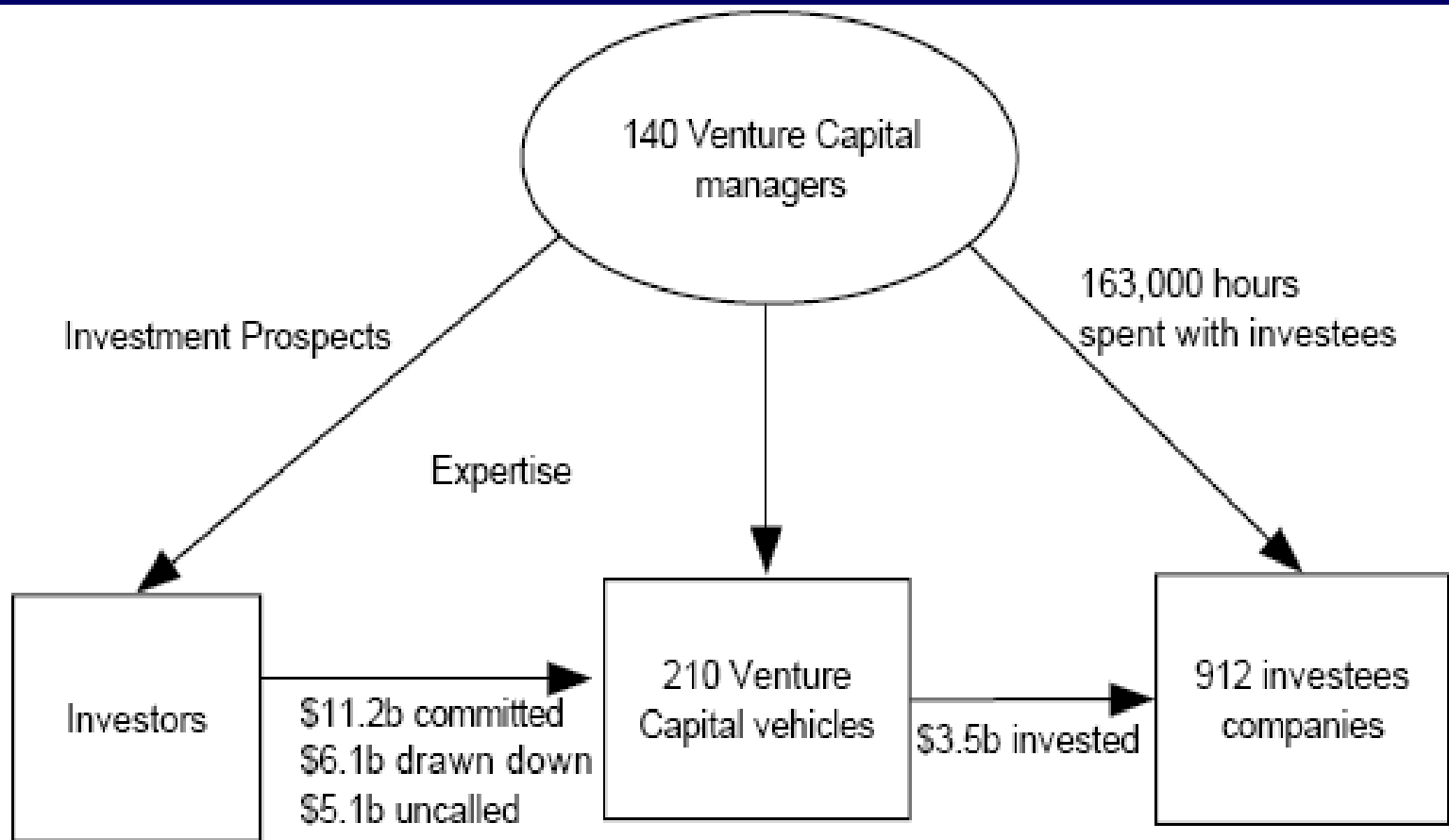
Stages of VC investment

- Seed, Yr 1-2
- Early, Yr 2-4
- Expansion
- Turnaround
- Late
- Listed buyout/management buyout/buyin



VC investment via intermediaries

- ABS Report, Nov 2005

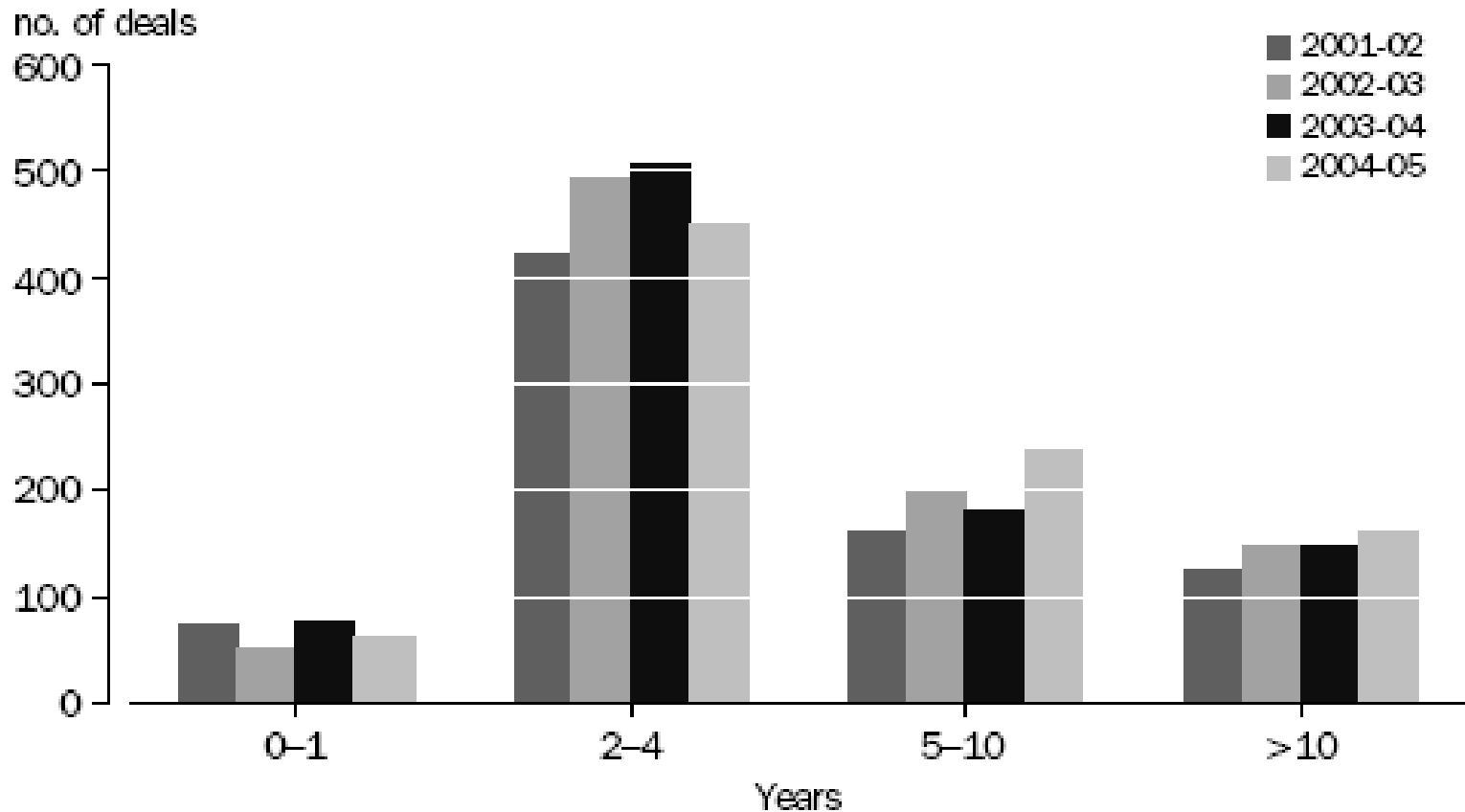




VC Investment – Deals

- 50% of deals: companies aged 2-4

NUMBER OF DEALS, by age of investee company

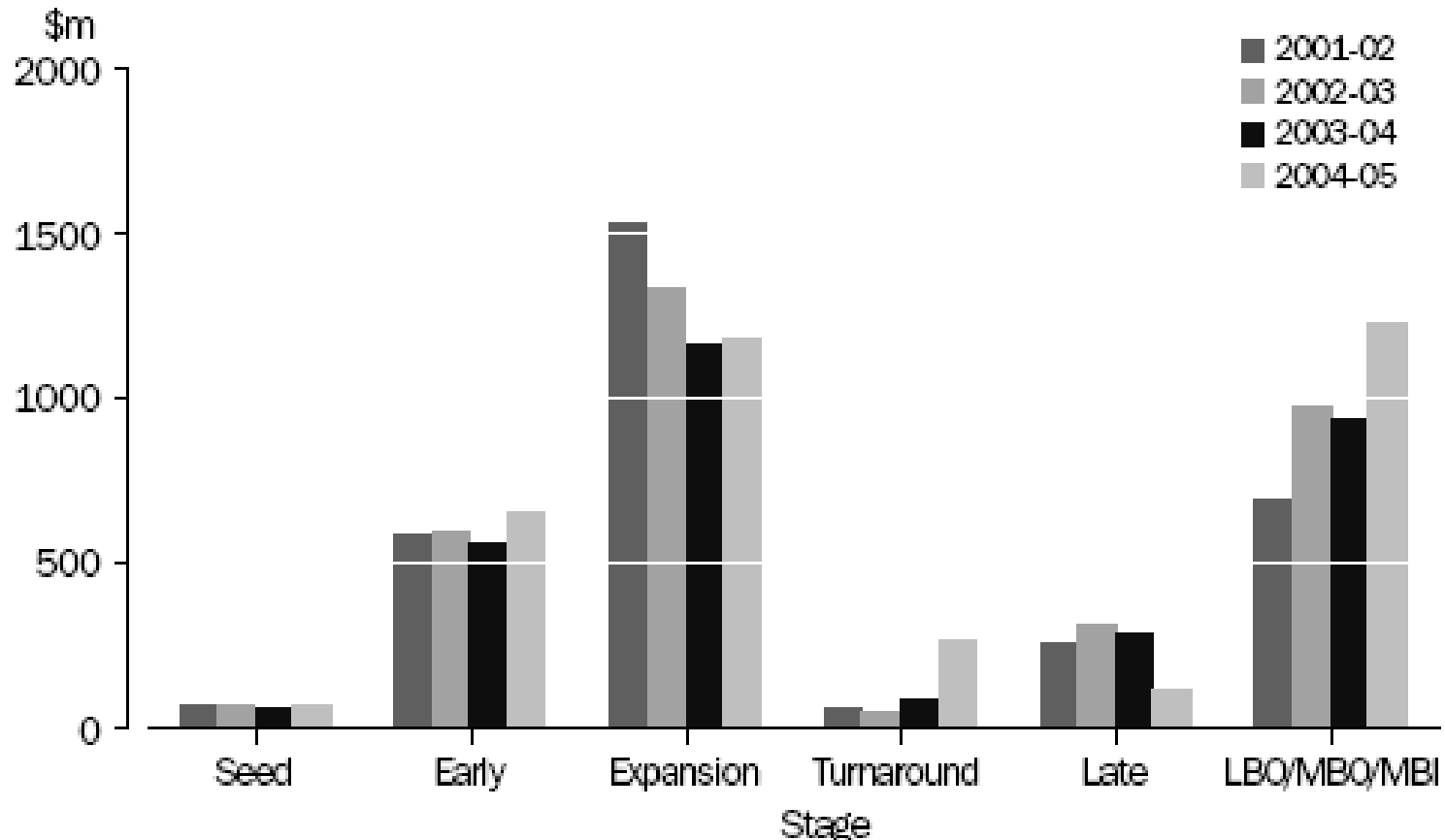




VC Investment – Stages by value

- Focus on Expansion – but note Buyouts

VALUE OF INVESTMENT, by investee stage





The US VC model

Limited partner investors

Percentage interest

Flow thru gains/losses



General partner VC managers

20% carried interest

< 1% in losses



Gain



Loss



VC investor profile

■ US

- 60% tax-exempts: pension funds, foundations
- Balance are taxable individuals and corporates
- Small proportion non-residents

■ VC investors in Australia

- Mostly taxable investors: Corporates, banks and insurance, individuals, trusts
 - Super funds – about 35%
 - Non-resident – about 11%
- Scarcely any tax-exempts



PDFs

- Companies
- Concessional tax rate
- Dividends exempt or frankable
- No loss flow through
- Investments - \$50M



VCLPs

- Flow through of gains and losses
 - Loss limitation for ordinary losses
- Exemption for capital and ordinary gains on disposal of shares/options in eligible investee companies
 - Tax-exempt investors from Canada, France, Germany, Japan, UK, USA
 - Minority taxable limited partners from 13 specified countries
- Manager “carried interest” CGT concession



VCLP investment restrictions

- Value of assets of company < \$250 M
- Shares/options in resident unlisted investee companies (at risk, 12 months)
- Not more than 30% capital in investee
- Location in Australia
 - Australian resident company
 - > 50% of people engaged to perform services do that primarily in Australia
 - > 50% of assets situated in Australia for at least first 12 months



Asset/activity/employee test

■ Ineligible activities

- Land development/ownership, public infrastructure, banking, leasing, securitisation
- Derivation of “passive” income: rents, interest, dividends, royalties

■ Company satisfies at least 2 of:

- > 75% of assets used
- > 75% of employees engaged
- > 75% of total income from

activities that are not ineligible activities



Features of Australian tax programs

- Registration and substantial bureaucratic oversight
- Capital and investment value restrictions
- Time limits
- People, assets, income in Australia
- Limited foreign country investor eligibility
- Loss flow through for VCLPs but not PDFs; loss limitation
- Complexity



Policy issues

■ Cost/benefit analysis

- Both costs and benefits are difficult to measure
- Costs –tax expenditure analysis
- Benefits –data collection and measurement

■ Design - front-end/back-end

- Front-end: tax avoidance; backing “losers”
- Back-end: is it enough incentive given the high proportion of losers to winners?
- A simplistic analysis - real effects of legal form



More policy questions

- Targeting
 - “Later stage” vs earlier stage
 - Size of business
 - Location
 - Employees
 - industry sector
- Increasing number, skill, ability and active engagement of VC managers
 - Or just increasing their incomes?



Early stage spin-off companies

- “Angel” investor subsidy
 - Eg, rollover for SME investments
- Entity design
 - limited liability
 - Flow through of tax losses
- Ease of “entry” and “exit” of investors
 - Eg, Ability to distribute investee co shares tax-free
 - Scrip for scrip rollover for buyouts