

On 14 October 2014, the Australian Government announced changes to the Significant Investor Visa (**SIV**) program and the introduction of a Premium Investor Visa (**PIV**) as part of a package of policy initiatives aimed at promoting investment and innovation in Australia and in particular, to provide a much needed capital injection for Australia's venture capital industry.

On 1 July 2015, the Australian Government implemented the [new SIV](#) (AU\$5 million) and PIV (AU\$15 million) investment requirements under the new 'Complying Investment Framework' developed by Austrade. In our [recent article](#), we provided an overview of the new Complying Investment Framework (re-cap below and found on [Austrade's website](#)).

For SIV applicants, the key change is the restriction to investing in eligible fund managers who:

- for each of the AU\$1.5 million small cap fund and AU\$3 million balanced fund components of the complying investment, have funds under management (**FUM**) of at least AU\$100 million; and
- for the AU\$500,000 venture capital/private equity component of the complying investment, operate a regulated venture capital limited partnership (**VCLP**), a regulated early stage venture capital limited partnership (**ESVCLP**) or a regulated Australian venture capital fund of funds (**AFOF**).

For many SIV applicants, the question as to what is a VCLP, an ESVCLP or an AFOF as well as understanding Australia's venture capital industry generally will be largely unknown, in particular, in relation to:

- understanding who are the different fund managers, their track records and investment focus;
- standard investment terms;
- typical fee structures;
- usual risk metrics;
- specific regulatory requirements; and
- the impact of the regulatory requirements on the fund and its investors.

Having regard to the Department of Immigration and Border Protection (**DIBP**)'s published information that 751 SIVs were granted between 24 November 2012 and 31 March 2015, if over the next three years, the same number of SIVs are to be granted, this will mean an additional AU\$375.5 million being invested into Australia's venture capital industry.

As a result, we envisage there will be a major educational role to be played by professional service providers engaged by SIV applicants to assist them in their understanding of the Australian venture capital industry.

In this article, we provide an overview of Australia's regulated venture capital funds and the SIV complying investment requirements into venture capital.

What is an Australian Venture Capital Fund?

An Australian venture capital fund is a fund which is registered with Innovation Australia in the form of either:

- a regulated venture capital limited partnership (**VCLP**);
- an early stage venture capital limited partnership (**ESVCLP**); or
- an Australian Venture Capital Fund of Funds (**AFOF**).

In each case, the fund must meet the relevant criteria (for the type of fund) in the *Venture Capital Act 2002*, *Income Tax Assessment Act 1997* and *Income Tax Assessment Act 1936* (either fund is referred to in this article generically as a **VCPE**).

Some of these key criteria include:

- A VCLP must seek to raise a minimum of AU\$10 million and not more than AU\$250 million for investing into unlisted Australian businesses (an ESVCLP must not raise more than AU\$100 million for investing into early stage Australian businesses).
- A VCLP and an ESVCLP must only invest in new shares, units, options or convertible notes that have an equity characteristic in these Australian entities (companies or trusts) where at least 50% of the entities' assets and staff are located in Australia and the relevant entity must not have property development, land ownership, finance or construction as its predominant activity.
- An ESVCLP must have a plan to invest in early stage venture capital investments, which includes investment in businesses at the pre-seed, seed, start-up, and early expansion stage of development.
- There are restrictions against (and limited opportunities for) VCLPs or ESVCLPs to invest in loans, pre-owned shares or invest in non-Australian entities.
- Investments by a VCLP must be in Australian entities with total assets not exceeding AU\$250 million and for an ESVCLP, not exceeding AU\$50 million.
- A VCLP and an ESVCLP must not invest more than 30% of its committed capital in any single entity.

The advantage of investing in either a VCLP, an ESVCLP or an AFOF is that each fund is entitled to flow-through tax treatment (i.e. it is not a taxing point).

A VCLP's eligible foreign investors do not pay capital gains tax (CGT) on their share of the returns the VCLP makes on eligible venture capital investments. Returns to domestic investors are taxed in their hands, but subject to the CGT discount for investments held for more than 12 months.

Investors in an ESVCLP pay no tax at all on their share of returns (capital or income) on the disposal of an eligible investment.

There are currently 12 registered ESVCLPs and seven conditionally registered ESVCLPs, while there are 40 registered VCLPs and four conditionally registered VCLPs. There is only one currently registered AFOF (and accordingly the focus of this article is on VCLPs and ESVCLPs).

You can view a list of eligible VCPEs for [VCLPs](#) and [ESVCLPs](#) on the Australian Government website.

Conditional registration is granted where the fund does not have at least AU\$10 million committed capital but has demonstrated sufficient evidence to satisfy Innovation Australia it is likely to raise at least AU\$10 million within two years. If the fund does not raise at least AU\$10 million in two years, its conditional registration lapses (unless renewed through re-application). A conditionally registered VCLP or ESVCLP may in certain circumstances make investments. However, the VCLP or ESVCLP must gain full registration before it realises any gains for the tax benefits to apply. A conditionally registered VCLP that has its conditional registration lapse may reapply for registration.

Innovation Australia is the Australian organisation which manages the registration and ongoing monitoring of VCPEs, which is an independent statutory body with a mandate to administer some of the Australian Government's innovation and venture capital programs. Innovation Australia is supported by AusIndustry in the administration of these programs, a division of the Department of Industry and Science. AusIndustry administers the VCLP and ESVCLP programs strictly in accordance with the relevant criteria and fund managers seeking registration of a VCPE must adhere to the relevant criteria in establishing and continually operating the fund, including in respect of meeting their quarterly and annual reporting requirements to AusIndustry. As a result, venture capital funds in Australia are subject to significant regulatory oversight.

How Are SIV Applicant's Funds to be Invested in Venture Capital?

A SIV applicant must have entered into a commitment for an investment of at least AU\$500,000 with a VCPE within 12 months from the grant by DIBP of the provisional SIV.

If the relevant VCPE is not able to employ the funds straight away, the AU\$500,000 must be invested in a cash management trust (CMT) held in escrow or an Australian bank account as security for a bank guarantee in favour of the VCPE, to meet capital calls of the VCPE over the investment horizon for the fund. Thereafter, the SIV applicant must be able to demonstrate that investments in the VCPE fund have commenced within four years from the grant of the provisional SIV.

Investors should be aware that VCLPs and ESVCLPs typically have an investment horizon which is longer than four years and SIV applicants may be required under the terms of the relevant fund to maintain their investments in a VCLP or a ESVCLP for longer than a four-year period (even though that is not a requirement under the relevant SIV regulations).

What Do These SIV Investment Changes Mean for Australia's Venture Capital Industry?

AVCAL CEO Yasser El-Ansary has been quoted as stating "*These [SIV] changes have the potential to fundamentally transform the landscape for investment capital available for thousands of start-ups and tens of thousands of SME businesses*".

According to recent AVCAL statistics, in FY2014, AU\$120 million was raised by venture capital funds in Australia, with over half that amount sourced from high-net-worth individuals. During the same period, both domestic and foreign venture funds invested a total of AU\$516 million into 93 businesses. Between November 2012 and March 2015, 751 visas were granted. If over the next three years, the same number of visas are to be granted, this will mean an additional AU\$375.5 million being invested into Australia's venture capital industry.

El Ansary further commented that "*this deeper pool of capital*" will help to prevent the "*brain drain*" of our best entrepreneurs moving abroad simply to gain access to capital from a larger market", such as the UK or the US. The convergence of the SIV venture capital investment requirements and the launch of two new Fintech hubs in Sydney in 2015 may not be as coincidental as one might think. It is expected that this additional capital will enable venture capital fund managers to assist new high growth technology businesses being backed in Australia, rather than needing to source funds from offshore (see our related [Fintech article](#)).

While AVCAL has been positive about the news¹ and certain commentators have reported "*the Investor Visa changes are massive improvements for the start-up world*"², other commentators have not been so encouraging. In a recent article "Significant Investor Visa misses the mark on VC and innovation", the writer, Jo-Ann Suchard, criticises the new SIV regime for having "*fallen short in a number of key areas*"³, for example, due to the small amount contributed to innovation (being a mere 10%) and the requirement for a four year investment period not matching the reality that most venture capital funds operate on an 8 to 10 year investment life cycle. Ms Suchard suggests that our SIV program could have required a longer term investment commitment, beyond the date for the granting of permanent residency (as which applies under the Canada immigration venture capital pilot program).

1 "*The Australian government just made a huge change that will pour millions of dollars into venture capital*", 15 May 2015, Alex Heber (<http://www.businessinsider.com.au/Alex-heber>) and "*Changes to Significant Investor Visa program good news for Australian startups and SMEs*", 15 May 2015 (<http://www.avcal.com.au/news/2015>)

2 "*Significant & Premium Investor Visas – The Australian Government's Stroke of Genius No One Noticed*". (<http://startup88.com/opinion/2015>)

3 "*Significant Investor Visa misses the mark on VC and innovation.*" Jo-Ann Suchard, Associate Professor, Banking & Finance at UNSW Australia

In another article "Changes to venture capital SIV rules will turn investors away from Australia: Ausin Group"⁴, the new rules are criticised for allocating funds to "high risk investments" which SIV applicants will likely not understand and may be reluctant to be invested in. In this article, Ausin's⁵ immigration consultants are stated to "expect investors to shun Australia's SIV program and start to look for more viable alternatives such as business visas or the Investor Stream Visa".

Notwithstanding some of these negative responses, we expect that new capital being injected into Australia's venture capital industry can only be positive for developing innovation and Australia's venture capital industry.

Will All the Funds Required to be Invested into Venture Capital for SIV Be Able to Be Employed?

There is an overhanging question as to whether all of the funds required to be invested into venture capital for SIV purposes (i.e. AU\$500,000 per applicant) will be able to be employed in Australia's venture capital industry. One can envisage that the increased fund flows expected through the SIV program will encourage new fund managers to enter this space. Time will tell whether the expected AU\$375.5 million in additional funding over the next three years will find VCPE investment homes.

Even if the funds can be deployed, the key challenge will be deploying the funds into profitable venture capital investments in particular if restricted to the provisional visa four year term. As noted above, we would expect that many VCPE fund managers will require their SIV applicants to invest for more than a four year term in order to offer viable investment opportunities (since most venture capital investments have a longer investment term).

What is Involved in Establishing a Venture Capital Fund?

As stated above, the establishment of a venture capital fund is a regulated process requiring the approval and registration of Innovation Australia, as administered by AusIndustry and the Australian Taxation Office (ATO).

The VCLP and ESVCLP programs are stringently regulated and fund managers wishing to establish a new VCPE need to be aware of the requirements for:

- licensing requirements under the Australian Financial Services License regime;
- specific legal documentation, including a tailored limited partnership deed;
- the regulatory and taxation requirements for the VCPE, including fund size, investment criteria and reporting obligations; and
- not an insignificant amount of start-up capital to undertake the registration and prepare the documentation involved in establishing and initially managing a VCPE.

⁴ "Changes to venture capital SIV rules will turn investors away from Australia: Ausin Group", Jonathan Chancellor, 19 March 2015 (<http://www.propertyobserver.com.au/forward-planning/advice-and-hot-topics>)

⁵ Ausin is one of Australia's largest privately owned companies providing property, immigration and financial services advice to both Australian and Asia Pacific markets.

There are helpful materials on the business.gov.au website provided by the Department of Science and Industry setting out the criteria and registration process for establishing a [VCLP](#), [ESVCLP](#) or AFOF.

How Can We Help?

We are able to advise in every aspect of venture capital with our highly experienced team all of whom have complementing experience from funds management through to taxation advice. We have a particular differentiator in the marketplace with an in-house PRC-qualified lawyer and a Mandarin qualified translator.



Michelle Segafort

Partner, Sydney
T +61 2 8248 7830
E michelle.segafort@squirepb.com

Michelle Segafort is a partner in the corporate and financial services practices who is widely acclaimed by her peers and winner of industry awards. She has particular funds expertise in advising corporations on the development and set-up of SIVs.



Richard Horton

Partner, Palo Alto/Sydney
T +1 650 843 3313 or +61 2 8248 7806
E richard.horton@squirepb.com

Richard Horton is an experienced, dual-qualified US and Australian corporate and technology lawyer, advising clients in both the United States (in particular Silicon Valley) and Australia. He brings particular expertise to start-ups and emerging companies becoming established in Australia and knowledge of the venture capital industry.



Louise Boyce

Of Counsel, Sydney
T +61 2 8248 7802
E louise.boyce@squirepb.com

Louise Boyce is a taxation lawyer who is able to provide the advice especially in relation to transactional taxation, thin capitalisation, cross border re-domiciliations and foreign owned corporations looking at inbound opportunities.



Tina Zhou

Senior Associate, Perth
T +61.8.9429.7498
E tina.zhou@squirepb.com

Tina Zhou is a qualified lawyer in the People's Republic of China. She uses her cultural and language abilities to build relationships with existing Chinese clients, Chinese investors seeking opportunities in Australia and Australia-based clients looking to conduct business in China.



Ning Cao

Translator, Perth
T +61 8 9429 7436
E ning.cao@squirepb.com

Ning Cao is accredited by NAATI (National Accreditation Authority for Translators and Interpreters). Ning’s legal translation expertise bridges the gap between our Chinese clients and our Australian practitioners. She works closely with English speaking lawyers to provide Chinese translation on a wide range of complex legal documents.



Andrew Burnett

Of Counsel, Perth
T +61 8 9429 7414
E andrew.burnett@squirepb.com

Andrew assists government and private employers on managing legal, commercial and reputational risks associated with employment, occupational health and safety and industrial relations issues. A registered Migration Agent (MARN 1174849), he is able to work with inbound companies with the intention of employing Australian and non-Australian workers.

Our key strengths include integrated advice in migration, financial services, funds, venture capital and taxation, such that we can offer the best options for structuring your financial arrangements and assist you to have a strong understanding of the regulatory issues that impact your arrangements. We assist SIV applicants and investors by providing a broad range of services including visa applications, introductions to fund managers, structuring and carrying out due diligence processes for investments and advising on taxation and other regulatory issues. We also have significant experience supporting fund managers and other financial service providers with their SIV strategies, including licensing, fund formation and ongoing fund operations.

Re-cap on New SIV and PIV Requirements from 1 July 2015

SIV

The SIV investment requirements from 1 July 2015 include the following:

- **(Venture capital investment – AU\$500,000)** at least AU\$500,000 must be invested into venture capital and growth private equity funds (being an AusIndustry registered fund which is either an ESVCPL, VCPL or AFOF);
- **(Small Cap Fund investment – AU\$1.5 million)** at least AU\$1.5 million must be invested into funds/listed investment companies investing in emerging companies (**Small Cap Fund**), with requirements including that that the relevant Small Cap Fund’s investments must be:
 - at least 80% in ASX listed or unlisted companies with market caps less than AU\$500 million (subject to only 20% of the fund’s assets being in unlisted companies);
 - up to 20% may be invested in foreign exchange listed companies on other Australian stock exchanges;
 - up to 10% may be invested in foreign exchanged listed companies;
 - in a minimum of 20 investee companies,

and the fund manager of the relevant Small Cap Fund must have at least AU\$100 million firm-wide FUM; and

- **(Balanced Investment Fund – AU\$3 million)** the remaining amount of up to AU\$3 million may be invested into other investment funds/listed investment companies – investing, for example in companies, A-REITS, infrastructure trusts, convertible notes, corporate bonds, deferred annuities, real property (subject to 10% limit on residential real estate) etc. (**Balanced Investment Funds**) and the fund manager of a relevant Balanced Investment Fund must have at least AU\$100 million firm wide FUM.

Other requirements for complying investments are:

- **(independence)** fund managers must be independent from the SIV applicant and their spouse;
- **(fund of funds and IDPS permitted)** Small Cap Fund and Balanced Investment Fund complying investments are permitted through a fund of fund or an Investor Directed Portfolio Service (**IDPS**), provided that the amount invested into a fund of fund or IDPS is invested into the minimum required amount for each type of the complying investment within the fund of fund or IDPS;
- **(funds held in cash)** SIV applicant funds may be held in cash for up to 30 days during any switching period within the four year investment period required for the continuation of the provisional SIV;

- **(no direct residential property investment and very limited indirect investment)** direct investment into residential real estate is excluded and indirect exposure through Balanced Investment Funds is to be restricted to less than 10% of the fund's new assets;
- **(no loan back arrangements)** the amount invested in venture capital, Small Cap Funds and Balanced Investment Funds may not be used as collateral or security for the purpose of the SIV applicant borrowing back the funds to invest or deploy elsewhere.

SIV investors will be required to prove to the DIBP that each managed fund (whether a venture capital fund, a Small Cap Fund or a Balanced Investment Fund) that they invest in is a complying investment. The responsible manager or trustee of the relevant managed fund must make a declaration to DIBP that their services would be limited to the categories of investments in Australia as set out above and prescribed by the Minister in the *Migration (IMMI 15/100: Complying Investments) Instrument 2015*.

PIV

PIV is a different investment type of visa altogether and upon complying investments of AU\$15 million being made, provides for an immediate permanent residence status. PIV applicants will be nominated only through Austrade (through an invitation-only model), with State and Territory Governments able to make referrals to Austrade. The Australian Government will be highly selective in determining who is offered the opportunity to apply for a PIV, and unsolicited expressions of interest will not be accepted. Austrade assesses all PIV applicants and nominates them based on approved criteria related to entrepreneurial skill or talent and ongoing benefit to Australia and character/integrity checks. The scope of eligible complying investments are broader and include managed funds as well as direct investments in Australian proprietary limited companies, real property (excluding residential property) and Australian securities exchange listed assets. PIV investors may also elect to make a portion or the entirety of their complying investment by way of a philanthropic donation (endorsed by a State or Territory Government).

The contents of this update are not intended to serve as legal advice related to individual situations or as legal opinions concerning such situations nor should they be considered a substitute for taking legal advice.

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