

Small Australian startups are one step closer to accessing equity crowdfunding

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Treasurer, Scott Morrison has today introduced legislation that will extend crowdsourced equity funding (CSF) to proprietary companies. Following a public consultation in May 2017, the draft legislation was amended to bring us the *Corporations Amendment (Crowd-sourced Funding for Proprietary Companies) Bill 2017 (CSF Bill)*, which has now been formally introduced to parliament for consideration.

This article outlines the key changes to the CSF Bill following consultation and how this will open up CSF much more broadly in Australia if passed.

Key changes to draft legislation

Following the consultation process undertaken in May 2017, there have been a number of key changes made to the mechanics of the CSF Bill for proprietary companies.

- **Takeovers:** One of the challenging aspects of the draft legislation was that the takeover rules in Chapter 6 of the *Corporations Act* would still apply to a company unless the company's constitution provides a minimum level of protection to investors. This would have required an investor who acquired more than a 40% relevant interest to offer to purchase all other voting shares in the company on the same terms within 30 days. In a welcome move, this requirement has been removed and proprietary companies who use CSF will not be subject to the takeover rules, as long as they meet any of the conditions prescribed in regulations (which are yet to be seen).
- **Audit requirement:** It was originally proposed that proprietary companies that raised more than \$1 million from CSF offers would need to have their annual financial reports audited. This threshold has now been lifted to \$3 million and it is proposed that the threshold at which public companies using CSF must have their accounts audited will also be lifted from \$1 million to \$3 million.
- **Recognition of transfer of CSF shares:** Amendments have been made in order to recognise that CSF shares may be transferred. As long as these transfers occur prior to the company's shares being traded on a financial market, the new holder will not count towards a proprietary company's shareholder cap and this will not impact on a proprietary company's ability to remain as a proprietary company. It is also intended that there will be flexibility if a market for trading CSF shares is established. The CSF Bill also notes that proprietary companies will be able to manage their shareholder base by having clauses in their constitution dealing with transfers of shares.

Further information regarding the draft legislation released in May 2017 was outlined in our previous article.

Overview of key practical matters for proprietary companies

Companies often prefer to remain as a proprietary company rather than converting to a public company, which brings more onerous compliance obligations and regulation with it.

If the CSF Bill is passed, this will allow proprietary companies to access the CSF funding regime without having to convert to a public company. However, those companies will be subject to special investor protection provisions.

The following are the key practical matters that will impact the ability for proprietary companies to use CSF if the CSF Bill is passed:

- **Directorship:** A proprietary company must have a minimum of two directors to be able to access the benefits of the CSF regime, the majority of which must ordinarily reside in Australia. Additional requirements may be specified in regulations from time to time, however, these are not as yet known.
- **Shareholder Caps:** CSF shareholders (or shareholders who are transferred CSF shares) will not be counted as part of the shareholder cap of 50 non-employee shareholders for classification as a proprietary company. See above for further details of this requirement. This means a proprietary company will not be required to convert to a public company where, purely as a result of a CSF offer, the number of non-employee shareholders exceeds 50.
- **Additional ASIC Reporting Obligations:** A proprietary company that undertakes a CSF offer will be required to include certain information as part of its company register and to notify ASIC of that information.
- **Financial Reporting:** Proprietary companies who have investment from CSF offers will be required to prepare annual financial statements (which are compliant with accounting standards) and directors' reports while they have CSF shareholders. This is not generally required for a proprietary company that has not undertaken a CSF offer.
- **Auditing:** Proprietary companies that have public investment in excess of \$3 million from CSF offers will be required to have their annual financial reports audited. Once this threshold is reached, steps must be taken by the company to have an auditor appointed within one month. Directors will be penalised for failure to do everything reasonably required to comply with the company's auditing obligations.
- **Related Party Transactions:** Chapter 2E of the *Corporations Act* (which applies to related party transactions) will now apply to proprietary companies that have CSF shareholders. These provisions create a variety of limitations and compliance obligations when a company is dealing with related parties such as a director or controller and often require shareholder approval of such dealings.
- **Takeovers:** Proprietary companies with CSF shareholders will be exempt from takeover rules in Chapter 6 of the *Corporations Act*.

When will we see these changes come into effect?

The application of CSF regime to proprietary companies will come into effect six months after the CSF Bill receives royal assent. While the CSF Bill has not as yet been passed and must go through the usual approval processes, the changes to be implemented by the CSF Bill are generally in line with those suggested by the opposition party in March of this year. If the CSF Bill is passed, the changes will evidently lag behind the implementation of the *Corporations Amendment (Crowd-sourced Funding) Act 2017 (CSF Act)* (which comes into effect on 29 September 2017). For further information about the CSF Act, please see our previous alert.

If you would like to discuss how crowdsourced equity funding could benefit you or your company, contact HopgoodGanim Lawyers' Corporate Advisory and Governance Team.

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