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Invest in the future

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WHAT SHOULD YOU LOOK FOR IN AN **INVESTMENT OPPORTUNITY?**

Whatever reasons you have for investing in an exciting new company, always make sure the business you have in mind ticks these six boxes. Cassi Camilleri writes.

There are as many different motivations for anything in the world as there are people. Even then, multiple reasons can influence any one choice because everyone has varying needs and wants vying for their attention. As and investor, you are no different.

Understanding what makes you tick and why you make the decisions you make is critical in all aspects of life. It is especially relevant where money is involved, as in the case of honing in on a potential investment.

Are you motivated by money, or do you want to be a part of the next big thing? Do you want to have a hand in building the next Apple Computers, or do you want to share your resources with people making waves in the causes you believe in? If you do not have clear answers to these questions, some introspection might be in order. If you know how you feel about all this, then you can turn your attention towards the opportunity at hand.

Pragmatic analysis is critical when dealing with high-tech, high-growth companies that are promising to shake up the industry they're operating in. So here are six elements you need to look for before you jump into the fray.

A solid WHY.

Why does this business or group exist? What do they hope to achieve? Does this align with your values? Is it in line with the goals you have set for yourself over the next five to 10 years? Having a clear understanding of your own motives for getting involved in a project—as well as those of the people involved—is the first step in ensuring that you match with your prospective business partners.

A driven TEAM.

No product, intellectual property, or service was built or developed in a vacuum. People and talent lie at the core of it all. So if the idea is groundbreaking but the team is not working, then the choice should be obvious. Look for evidence that this business is being steered by competent individuals who are experienced and trustworthy. Among the most important skills to be included in this team are: leadership, management, sales, and accounting.

A thorough BUSINESS PLAN.

The team approaching you for investment have to have a clear and distinct vision for the path ahead, in writing, ready and waiting for you. Details are important, as they indicate just how much thought has been put into helping you understand how things are going to progress from nothing to something. This includes information on the market and industry you're going to be operating in, financial projections, even marketing plans.

Investment STRUCTURE.

If you're getting involved in equity finance, the money you invest is not 'on loan'. The company will not be making repayments. You are not going to get dividends on income. With equity finance, you are becoming an owner of the business together with the rest of the team. As a result, companies have to have a transparent structure that allows for your involvement and influence. Agreements need to be signed that clearly state the nature of your investment and its expected returns.

The opportunity to INFLUENCE.

Unless your goal is specifically to sit back while the team carry this business from A to B to C and bring in the returns as and when they happen, a conversation about roles needs to happen. Many times, investors get involved in innovative enterprises for more than just money. A significant portion of them want to help develop ideas; they want to be mentors to bright young professionals. If this is you, is the company happy to offer you a seat on the Board of Directors?

A viable EXIT strategy.

Are you going to be selling shares and relinquishing ownership of the company back to the team? Is a sale or merger on the cards? If so, is there a time frame set? If a team has not only thought about a way for you to step into your role but also prepped the way for you to bow out, there are high levels of confidence and trust you can expect to enjoy.

TAX CONSIDERATIONS ON **RAISING EQUITY FINANCE** IN MALTESE PRIVATE COMPANIES

A note on taxation by RSM Malta.

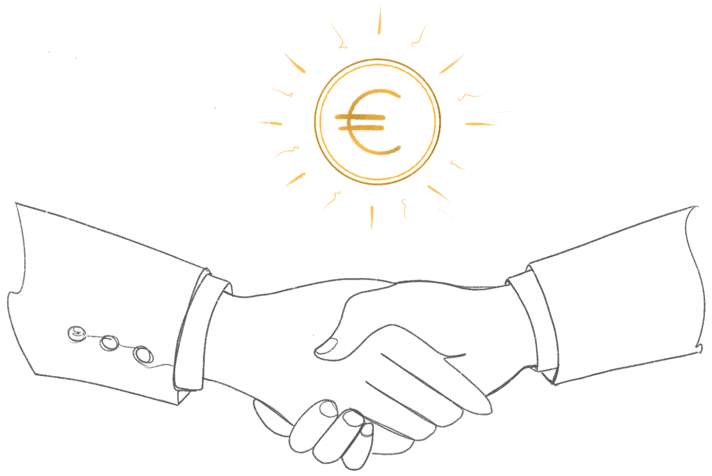
A key element for the growth of every start-up is securing the necessary finance and investor backing to bring to fruition the founders' plan. During the research and development phase of a high-tech, high-growth company, such companies would normally not have products on the market and not be generating revenue, making it very difficult to secure bank financing. Financing options would normally be in the form of equity finance – that is: the raising of capital through the issuing of new shares to business angels.

This essential part of a start-up's lifetime could also have tax implications through the application of what are referred to as the value shifting provisions. A value shift would occur where the value of shares held by a person has been reduced as a result of a change in the shareholding of such a company (through an issue or reduction of share capital), or a percentage change in voting rights attached to the issued shares, and such value passes into other shares held by another person even if there is no actual transfer of shares.

The provisions of the Income Tax Act impose tax (in terms of Article 5(13)) and the Duty on Documents and Transfers Act (in terms of Article 42B) impose transfer duty on this deemed transfer of value. Any deemed gain derived by the original shareholder shall be calculated by considering the difference between the tax value of the shares held immediately before and after the said change.

1. The tax value, which is based on the net assets of the company; and

2. The value that an investor or business angel will pay for an interest in the company that also factors in the potential growth and return that the investor may derive from the company on an eventual sale.



This article shall be focusing on the tax value of a company.

Not all situations where equity finance is raised give rise to a tax bill. In situations where an equity finance round does not bring about a reduction in tax value of the original shareholders, there will be no taxable event. Furthermore, the owners of high-tech, high-growth companies that do not own immovable property could apply for an exemption on a value shift, although this must be applied for from the tax authorities, ideally prior to the transaction. These different tax implications are outlined in the following example in two rounds of raising of equity finance carried out by ABC Limited.

ABC Limited is a start-up in a high-tech, high-growth industry and is seeking equity finance for the furtherance of its research and development activities. For the purposes of this exercise, we are assuming that it does not own immovable property; it has no assets and liabilities other than the cash received from its shareholders for the shares they hold. The founders have found investors that are willing to invest in the company at different stages and on different conditions

	Issued Shares	Percentage ownership	Nominal Value per share	Nominal Value	Tax Value per Shareholder
Founder 1	1,000,000	50%	€0.001	€1000	€1000
Founder 2	720,000	36%	€0.001	€720	€720
Founder 3	280,000	14%	€0.001	€280	€280
Total	2,000,000	100%		€2000	

Each founding shareholder has paid the nominal value for the shares held and is looking to develop the idea through the private limited company ABC Limited.

ABC Limited – Business Angel Investment Round 1

ABC Limited has secured an investment from a business angel who is willing to invest €500,000 for a 20% interest in the Company.

	Issued Shares	Percentage ownership	Nominal Value per share	Nominal Value	Share Premium Paid	Tax Value per Shareholder
Founder 1	1,000,000	40%	€0.001	€1,000	-	€200,800
Founder 2	720,000	28.8%	€0.001	€720	-	€144,576
Founder 3	280,000	11.2%	€0.001	€280	-	€56,224
Business Angel 1	500,000	20%	€0.001	€500	€499,500	€100,400
Total	**2,500,000**	**100%**		**€502,000**		**€502,000**

Business Angel 1 was willing to invest a significant share premium in the company, therefore increasing the tax value of ABC Limited as a whole. The tax value of each shareholder's interest in the company is calculated on the basis of this new increased tax value.

Investment Round 1 did not bring about a taxable value shift, as the tax value of the shares of each of the Founders has increased. In order to effect this change, certain filings and communication with the tax authorities will also be necessary.

ABC Limited – Business Angel Investment Round 2

Following two years of operations, ABC Limited did not achieve its technical target and requires additional financing for continued operations. In this regard, the company has secured investment from a business angel who is willing to invest €200,000 for a 28.57% interest in the Company.

	Issued Shares	Percentage ownership	Nominal Value per share	Nominal Value	Share Premium Paid	Tax Value per Shareholder
Founder 1	1,000,000	28.57%	€0.001	€1,000	-	€200,571
Founder 2	720,000	20.57%	€0.001	€720	-	€144,411
Founder 3	280,000	8%	€0.001	€280	-	€56,161
Business Angel 1	500,000	14.29%	€0.001	€500	€499,500	€100,286
Business Angel 2	1,000,000	28.57%	€0.001	€1,000	€199,000	€200,571
Total	**3,500,000**	**100%**		**€702,000**		**€702,000**

Although Business Angel 2 also invested a significant share premium in the Company and the tax value of the Company increased further, when considering the percentage shareholding that Business Angel 2 is receiving, the tax value of the shares of each of the shareholders prior to Investment Round 2 has decreased, and the tax value of Business Angel 2 is actually higher than the amount invested in the Company.

Investment Round 2 has therefore brought about a potentially taxable value shift. However, in terms of one of the provisos to Article 5(13)(b)(ii) of the Income Tax Act, as ABC Limited does not own property and the Commissioner for Revenue is satisfied that the change is being made for a bona fide commercial reason and is not part of an arrangement the main or one of the main purposes of which is the avoidance of tax, no tax shall be chargeable on any such deemed transfer or value shift.

In our view, the proposed value shift resulting from Investment Round 2 would appear to satisfy the bona fide commercial reason requirement and is not being carried out with a view to avoid tax, therefore we would expect that a confirmation that the value shifting provisions would not apply should be forthcoming from the tax authorities.

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PARLIAMENTARY SECRETARIAT FOR EUROPEAN FUNDS AND SOCIAL DIALOGUE

INTERREG V-A Italy-Malta Programme
Project part financed by the European Union
European Regional Development Fund (ERDF)
Co-financing rate: 85% EU Funds; 15% National Funds