SARS delivers on venture capital tax incentives

Enhancements to venture capital tax regime should boost small business access to funding

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Johannesburg, 31 July. Two proposed changes to Section 12J of the Income Tax Act will have a positive impact on the South African venture capital industry and stimulate investment into privately owned entrepreneurial businesses in South Africa.

A higher investee asset threshold, as well as a permanent investment deduction, will increase the appeal of venture capital as an investment asset class, at the same time giving a boost to small business development and job creation.

Government first implemented a venture capital company (VCC) tax regime in 2009. A VCC is an investment vehicle through which a number of investors can fund a portfolio of business interests.

“The original tax concessions in the VCC regime were intended to promote access to equity finance by privately owned businesses -- but the take-up of the allowance has been limited,” says Southern African Venture Capital & Private Equity (SAVCA) CEO, Erika van der Merwe. “Our industry and its partners, including the SiMODiSA initiative, have been working closely with government on enhancing these provisions, and the recently released Draft Taxation Laws Amendment Bill demonstrates Treasury’s commitment to stimulating investment across the venture capital industry.”

The Section 12J amendments have been welcomed by venture capital funds. “They significantly enhance the attractiveness of tax incentives available to venture capital investors,” says van der Merwe, “And in turn this should stimulate greater levels of investment into small and medium-sized businesses in South Africa.”

Van der Merwe commends the efforts of Treasury and government. “We have been impressed with SARS’ willingness to engage in open dialogue in this regard. Many small businesses struggle to obtain growth capital as there are not many investment companies that focus on the SME space. The Section 12J improvement is yet another step by government to make it easier for smaller businesses to function and thrive, grow sustainably and create jobs. We trust that, in time, additional steps will be taken to support entrepreneurship and funding of early-stage ventures.”

The first key taxation amendment is that the total asset limit for qualifying investee companies (being the businesses in which the VCC may invest) has been increased to R50 million.

“Previously the VCC tax regime allowed VCCs to invest in companies with a maximum book value of R20 million,” explains Rick Basson, co-founder of Broadreach Capital, a SAVCA-member firm which has a registered VCC fund. “We believe that was too low and one of the principal reasons why the S12J incentive wasn’t taken up to any significant degree. A venture fund and its investment assets need to be of a certain size in order to appeal to fund managers. Quite simply, it was not economical for fund managers to set up funds to invest solely in assets of that size, and the level of risk involved in such small investments kept most investors away.”

Basson is confident that with the increase to a R50 million asset limit, these concerns will largely be removed.
The increased asset threshold should have a positive effect on the economy. “This incentive will support very early stage tech companies and start-ups with almost no assets. And it will also stimulate investment in the real job creators, being the SMEs, across various industries,” says Basson. “Particular beneficiaries will be the many established and growing SMEs in education, franchising, telecommunications and renewable energy industries. These businesses have asset bases of over R20 million, and with the proposed changes to Section 12J, we will be now be able to invest in them.”

Jeff Miller of Grovest, South Africa’s first Section 12J VCC, also comments on this welcome change: “Being able to invest in qualifying companies with assets of up to R50 million certainly increases our potential investment universe.”

The second Section 12J amendment relates to the deduction available to an investor subscribing for shares in a VCC. At present, this deduction is immediate and for the full amount of the investment made – however, it is recouped and becomes taxable if the investor sells the VCC shares at any time.

The improvement to this provision is that SARS will now allow the investment deduction to be permanent, as long as that investment is held for a five-year minimum period. There will be no reversal of the deduction on eventual disposal of an investment in a VCC, provided this holding period requirement is met.

Miller comments: "I have no doubt that, with the Section 12J allowance now becoming a permanent deduction, this will attract a large flow of investment into our fund, as individuals and trusts with high taxable income will want to take advantage of this new tax-efficient asset class."

Broadreach Capital compares the local taxation amendments to the UK and is hopeful that venture capital will now have broader appeal, particularly to individual investors. "The improved VCC regime mirrors the very successful Venture Capital Trust framework established in the United Kingdom," says Basson. "We hope that, as is the case in the UK, a VCC investment will eventually form part of the investment portfolio of most ordinary taxpayers once they realise the unique combination of excellent returns and economic stimulation that this form of asset class offers."

Keet van Zyl from SiMODiSA commends the announced changes, and expresses optimism that further amendments will follow to boost the South African venture capital industry. "The amendments to the VCC regime are welcome; our view is that additional steps are required to ensure that this tax structure is employed enthusiastically – and is truly effective. The changes indicated in the February Budget, which importantly covered, amongst other things, capital gains tax concessions for investors into VCCs, have not yet been implemented in full. We strongly believe their inclusion will significantly add to the potential impetus for industry growth that is much needed in our country."

The proposed Section 12J amendments will come into effect on April 1 2015.

About SAVCA: The Southern African Venture Capital and Private Equity Association (SAVCA) is the industry body and public policy advocate for private equity and venture capital in South Africa, representing about R160 billion in assets under management. SAVCA promotes South African private equity by engaging with regulators and legislators on a range of matters affecting the industry, providing relevant and insightful research on aspects of the industry, offering training on private equity and creating meaningful networking opportunities for industry players.

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