# SARS in venture capital move

**October 2018**
*Business Law & Tax Review*

Memorandum accompanying draft bill does not provide clarity regarding specific abusive structures

One of the more contentious amendments contained in the Draft Taxation Laws Amendment Bill published by National Treasury on 16 July 2018 relates to the application and implementation of the venture capital company regime contained in section 12J of the Income Tax Act.

The section was introduced in 2008 to facilitate access to equity finance by small and medium-sized businesses and junior mining exploration companies. To achieve this objective, taxpayers investing in a venture capital company are allowed an upfront deduction equivalent to the expenses incurred by a taxpayer in acquiring shares issued to that taxpayer by a venture capital company.

Although the initial uptake of the incentive offered in section 12J was not significant, it has more recently been demonstrated that of the 124 registered venture capital companies (two of which have been withdrawn), about ZAR3 billion has been raised and about ZAR1 billion has been invested in underlying investments. Despite the time horizon of 30 June 2021 for claiming the tax deduction, the benefits of section 12J include the ability to raise capital from sources that would not otherwise have invested in the SMME space, enabling more private equity and venture capital fund managers to operate in the SMME space and creating jobs.

With the increased investment in venture capital companies, the South African Revenue Service has concerns that the provisions of section 12J are being used for abusive tax structures. The 2018 Explanatory Memorandum accompanying the proposed changes to section 12J does not provide clarity regarding the specific abusive structures that have been identified.

To address the abuse of section 12J, the draft legislative provisions propose amendments to the effect that neither the qualifying company or the venture capital company can have more than one class of shares in issue. It has been suggested that the use of different share classes created the opportunity for abusive structures to be implemented. In the comments received in respect of the draft legislation, it has been noted that the use of a number of different class of shares

provides flexibility in, for example, the ability to raise different rounds of capital and channelling investments into different industrial sectors within a single venture capital company.

The proposal for abolishing the use of different share classes effectively meant that industry could not utilise legitimate structures.

Subsequent to the workshop held with National Treasury, it has now been proposed that changes be made in the 2018 draft bill so that no shareholder (with connected persons) in a venture capital company may hold, directly or indirectly, more than 20 percent of the shares of any class in a venture capital company. It is also proposed that the test regarding the class of shares be applied after a period of 36 months from the date those classes of shares are first issued by the venture capital company.

In response to the comment that the legislative changes should not have retrospective effect, it has been indicated that the effective date of the legislative changes will be changed to apply to any trading that commences, or classes of shares issued during years of assessment commencing on or after 1 March 2019.

Despite the change in stance adopted following the comments received and as indicated in the response from National Treasury, the industry still faces a degree of uncertainty. For existing venture capital companies, it appears that to the extent that there are existing share classes where the shareholder holds more than 20 percent of the shares in that particular class, the legislation will not have retrospective effect. However, it is unclear whether the 36-month test will be applied in respect of any of those existing share classes or if the existing share classes where the threshold of 20% is exceeded will not fall foul of the provisions of section 12J.

There is uncertainty about whether it will be possible for new share classes to be created subsequent to the legislation amendment date. It would seem that there has been some acceptance of the commercial justification for different share classes but the timing for creation and use thereof is not apparent from the response from National Treasury.

It is to be hoped that clarity will be provided by the publication of the amended Draft Taxation Laws amendment Bill but meanwhile the industry faces uncertainty. Ultimately, the question that will be asked is what future amendments will be made? Meanwhile, it is difficult to conduct business to ensure compliance.

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