Investments in venture capital companies not looking so attractive anymore

National Treasury yesterday released the draft bills for public comment, which once approved will serve to effect the legislative amendments announced as part of the 2019 Budget Review.

Of interest to the individual taxpayer and especially one whom has surplus funds available for investment is the proposed changes to cap the tax deduction available in respect of investments to the section 12J Venture Capital Companies (VCC). It is proposed to introduce a cap of R2.5million per annum per investor.

If the proposal is approved the amendment will be effective retrospectively to 21 July 2019 (the draft bill release date) thereby mitigating opportunities for the investor to have made a substantial lump sum investment before the changes were introduced.

The main reason for the introduction of the VCC legislation and its beneficial tax dispensation, more than 10 years ago, was to raise funding in support of and to quote from the Explanatory Memorandum, *the socio-economic development of small business which otherwise would not have had access to market funding due to either or both their size and inherent risk.* And based on the substantial amounts invested it seemed that many an individual taxpayer was whole-heartedly behind this initiative!Whether looking to diversify his or her investment portfolio or simply to legitimately reduce his or her tax liability many taxpayers took up the opportunity to purchase shares in the VCC as the cost of the investment served as an immediate upfront tax deduction while no recoupment of such tax deduction is required where the shares are sold after 5 years.

On the eventual disposal of the VCC shares the principle tax rules will apply namely, if the individual taxpayer held such for long term investment purposes the Capital Gains Tax dispensation should be applied while if the shares were held for speculative purposes the profit or loss would on revenue account.

Therefore, an individual taxpayer whom is subject to normal tax at the maximum marginal tax rate of 45% would benefit from an immediate 45% tax saving on such investment. The proposal now limits such annual tax saving to a maximum of R1,125,000.00.

National Treasury has indicated its reasoning and thoughts behind the proposal, which seems more driven by the inability to counter tax avoidance at the VCC level rather than at investor level. Surely it is the investor whom should continuously be incentivised to invest in such government backed initiatives, because honestly where else will the funding come from?

National Treasury and SARS should surely focus on implementing and monitoring the anti-avoidance measures at the VCC level to ensure that the criteria to qualify as a VCC are strictly met. The fact that this VCC regime is also subject to a 12-year sunset clause, ending in June 2021, begs the question why National Treasury would make such drastic changes to the funding mechanism now, rather than waiting until the entire regime is up for reconsideration in less than 24 months?

On a practical note, since the R2.5million cap is applicable to any cost incurred on or after 21 July 2019 what will happen where an individual taxpayer has bought shares on 19 July 2019 for R5million and a further R2.5million shares on 22 July 2019 would the taxpayer qualify for an overall deduction of R7.5million in the current 2020 year of assessment or only the R2.5million? This is unclear from the draft legislation.

Furthermore, would the individual taxpayer qualify to claim as a tax deduction the balance of the expenditure in excess of the R2.5 million in the subsequent year of assessment, similar to the tax dispensation afforded to donations made to approved public benefit organisations?

These and many more questions will be posed to National Treasury by ourselves and our registered controlling body, the South African Institute of Tax Practitioners (SAIT), as clarity is vital before an individual taxpayer should consider investing more in the VCC.

–ENDS-

Note to editors

BDO in South Africa is the South African member firm of BDO International. BDO is the brand name for the BDO network and for each of the BDO member firms. The global BDO network provides audit, tax and advisory services in 158 countries, with over 64 300 people working out of 1,400 offices worldwide. Service provision within the international BDO network of independent member firms (the BDO network) is coordinated by Brussels Worldwide Services BVBA, a limited liability company incorporated in Belgium with its statutory seat in Brussels.

Media contact

Don Howell

Director, Head of Individuals, Trusts and Estates

BDO South Africa

+27 (0)10 590 7475

+27 (0)71 211 0727

dhowell@bdo.co.za