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**RE: DRAFT TAXATION LAWS AMENDMENT BILL (TLAB), 2018: COMMENTS PERTAINING TO KEY BUSINESS TAX INCENTIVE ISSUES**

We have attached the comments from the SAIT Business Tax Incentive Work Group on the 2018 draft Taxation Laws Amendment Bill pertaining to key business tax incentive issues. We appreciate the opportunity to participate in the process and would welcome further dialogue.

Please do not hesitate to contact us should you need further information.

Yours sincerely

**Duane Newman**  
**Chair of the Business Tax Incentive Work Group**

## BUSINESS TAX INCENTIVE SUBMISSIONS

### A. REVIEW OF VENTURE CAPITAL COMPANY RULES

#### 1. Treasury Proposal

In addition to a number of administrative and technical issues being addressed by the proposed amendments, the following proposals have been made in an attempt to close abusive schemes using the current venture capital company (VCC) regime:

- That a qualifying company can only have one class of share in issue from the time that the venture capital company acquires shares in the qualifying company;
- That the venture capital company can only have one class of share in issue;
- That substantially the whole of the amounts received or accrued to the qualifying company during a year from the carrying on of a trade was derived from unrelated persons. As such trade with a person holding a direct or indirect interest in the qualifying company or a connected person to such person is limited.

#### 2. Comment

##### Introduction

It has become apparent that the VCC regime is prone to abuse. In certain instances, it is being utilised for purposes other than the original intent. The incentive was never intended to act as a round-tripped form of capital investment from the investor's pocket back to the investor's own pocket. For example, where a company invests in a VCC which invests in a qualifying company which invests back into the company, ring-fenced through special classes of shares.

While we agree that these avoidance structures need to be defeated, we are concerned that the abuse of the VCC regime will work to the detriment of legitimate VCC structures. The current focus on differentiated shares is indeed a necessary condition to abusive schemes but unfortunately differentiated share classes are also necessary for many non-tax structures. Different classes of shares are regularly used for different classes of innocent investors. A different trigger to prevent the avoidance (while protecting the innocent) needs to be found.

The VCC regime has an important role to play in the financing of small and medium enterprises that contribute to the economy by, amongst other things, creating jobs. We query whether the VCC regime should not be reconsidered and/or redesigned to ensure that it meets its policy intent while addressing the room for avoidance. Such a process should, however, not undermine policy certainty or existing VCC structures. It may be that the current incentive is not the most effective means for achieving the desired growth (without the ancillary abuse). Perhaps, the regime should be wholly revised for future VCCs. We are concerned about the collateral policy impact of poorly designed incentives because the mischief can easily tarnish more reputable players and the concept of incentives altogether.

#### Specific comments on proposals

As far as the proposals made in an attempt to close abusive schemes using the VCC regime we have the following specific comments:

- As VCC's are set up and need to be marketed to attract potential investors, it is vital that the tax treatment of the schemes are clear from the outset. Significant marketing effort is currently being put into using VCC's as an investment vehicle which is stimulating new investment by investors.
- We support that the VCC regime design should be reviewed to ensure that it meets its original purpose to be a marketing vehicle that attracts retail investors (by which is usually meant individual investors) with the benefit of bringing together small investors as well as concentrating investment expertise in favour of the small business sector. However, the initial restrictions which were placed on corporate investors in VCCs have largely been removed. It is now possible for a VCC to be comprised solely of corporate rather than individual investors. We suggest a workshop with the various role-players either to re-align the VCC tax regime design with its original intention or to consider whether the current VCC tax regime design allows for permutations which goes beyond its original intention.
- Depending on the outcome of the discussions at the proposed workshop there may be a need for very specific VCC legislation with very specific definitions such as in the UK.
- Because of the need for tax certainty, the amendment should not have retroactive effect. The tax consequences going forward for existing structures should not change from what they would have been when the investors made their investments into the VCC. The current

proposal will have retroactive effect for existing structures which continue to breach any of the requirements in years of assessment commencing on or after 1 January 2019. This could result in a negative view by investors of incentives and a distrust in policy. We query whether the existing structures should not be grandfathered given that it may not be possible to unwind them without adverse consequences.

- The proposed amendments may have a number of unintended consequences including:
  - The requirement that the qualifying company may not have more than one class of share in issue may frustrate commercial requirements which are normal in these kinds of investment. For example, different classes of shares in the qualifying company may be used for multiple funding rounds and to create a cashflow waterfall within the qualifying company.
  - The requirement that the venture capital company may not have more than one class of share in issue may frustrate the use of the venture capital company as a vehicle to raise investment on an on-going basis. Various classes of shares provide the ability to practically deal with multiple fund raises. Creating a new venture capital company for each round of raising funds is expensive with onerous compliance and reporting requirements. Fund managers are often governed and incentivised by way of a separate class of share in the venture capital company.
  - The requirement that substantially the whole of the amounts received or accrued to the qualifying company during a year from the carrying on of a trade was derived from unrelated persons could compromise Enterprise and Supplier Development initiatives where there has to be a link between the customer and the supplier. This is an area where the venture capital company regime plays an important accelerator role. The wording of this proposal may also not capture some of the abusive structures for example where the investor gets the right of use of a holiday home rather than the qualifying company receiving amounts from the carrying on of a trade.

## **B. REVIEWING THE WRITE-OFF PERIOD FOR ELECTRONIC COMMUNICATION CABLES**

### **1. Treasury Proposal**

It is proposed that the write-off period for electronic communication cables be aligned irrespective of whether the cables are owned or leased by the taxpayer and used inside or outside of South Africa. Generally, the write-off period for these cables are reduced to 10 years but in the case of leased cables it will be the greater of 10 years and the number of years for which the taxpayer is entitled to use the cables. It is proposed that the amendment will apply to assets acquired or brought into use on or after 1 April 2019.

### **2. Comment**

The alignment and reduction in the write-off period to take into consideration technological advancements and other factors that affect the useful life of these assets is welcomed. As indicated, electronic communication cables are subject to technological development and obsolescence as well as to environmental factors that impact on their useful life. The shorter 10-year write-off period falls within the 10-year expected useful life requirement for a section 11(o) scrapping allowance. We recommend that a consequential amendment be made to section 11(o) to include the sections under which the capital allowances are claimed on these cables to ensure that they can qualify for a scrapping allowance when scrapped.