For investors with a higher risk appetite, or who have maxed out their Retirement Annuity, Pension Fund and Tax-Free Savings Account contributions, a Section 12J Investment into a SARS approved Venture Capital Company (VCC) is the perfect way to allocate capital in a tax-free way in order to maximise your tax deductions Any investment into a Section 12J Venture Capital Fund is fully tax deductible. This means that if you are in the top tax bracket, SARS is willing to give you up to 45% of your investment back!

Frequently Asked Questions

Below are answers to some of the more common questions relating to Section 12J of the Income Tax Act

What is Section 12J?

Recently, the South African Income Tax Act was amended through the introduction of Section 12J. Section 12J of the Act offers tax relief for investors who allocate investments into qualifying and registered Venture Capital Companies (VCCs). Section 12J represents an important step towards stimulating the supply of private sector venture funding by incentivising investors through tax deductions. The legislation is based on the success of the Venture Capital Trusts implemented in the United Kingdom more than a decade ago.

Why Section 12J?

It seems too good to be true that SARS would be more than happy to return money to Taxpayers. But there is a very good reason for this. The 2008 South African Budget Review found that one of the main challenges to the economic growth of small and medium-sized businesses was access to equity finance. Through Section 12J, the South African Government aims to stimulate the economy and promote investment in South African private companies, whilst providing tax benefits to investors. Section 12J is designed to encourage individual and corporate investors to invest in a range of smaller, higher-risk trading companies by investing through the VCCs

What is a Venture Capital Company (VCC)?

A Venture Capital Company, or VCC, is a company designed to provide individual and corporate investors with access to a range of companies which have the potential for large growth but need funds to unlock the potential growth. The VCC aims to make money by investing in these smaller trading companies. The VCC raises the funds required by the smaller trading companies by issuing equity shares to investors and the money is then allocated to those businesses that the managers judge to have the best prospects. VCCs are intended to be a marketing vehicle that will attract retail investors.

Which companies qualify to be Section 12J approved?

There are strict criteria to be met before SARS will approve a Venture Capital Company as a Section 12J VCC. The criteria include being FSB regulated and a registered financial services provider.

What is the Section 12J Investment Process?

In short, an investor invests in a SARS Approved Section 12J VCC. The VCC then issues a share certificate to the investor. The VCC then allocates capital to a qualifying investee (company in need in capital to reach growth potential). The investee then issues qualifying shares to the VCC. A full description on this process can be found in this article

Who qualifies to be a Section 12J Investor?

Any taxpayer can invest in an approved VCC. These can be individuals trusts, or corporate entities

Who qualifies to be a Section 12J Investee?

SARS sets strict criteria for companies which Section 12J approved VCC's can invest into. Criteria includes:

• The company's tax affairs must be in order (a tax clearance certificate must be requested from SARS to support this requirement);

• The company must be an unlisted company (section 41 of the Act) or a junior mining company; A junior mining company may be listed on the Alternative Exchange Division (AltX) of the JSE Limited;

• During any year of assessment, the sum of the "Investment Income" derived by the company must not exceed 20% of its gross income for that year of assessment;

• The company must not carry on any impermissible trades - these include financial services activities, financial or advisory services, casinos and other gambling related services and activities relating to alcohol, tobacco products or ammunition

How long must the VCF shares be held?

Current legislation dictates that the shares need to be held for a minimum of 5 years in order to avoid paying back the tax deduction. In other words, you can claim the tax deduction in the tax year in which the investment was made, but if you sell your Section 12J shares before 5 years, then you will need pay SARS any deduction that you previously obtained.

Is there a maximum annual and lifetime limit?

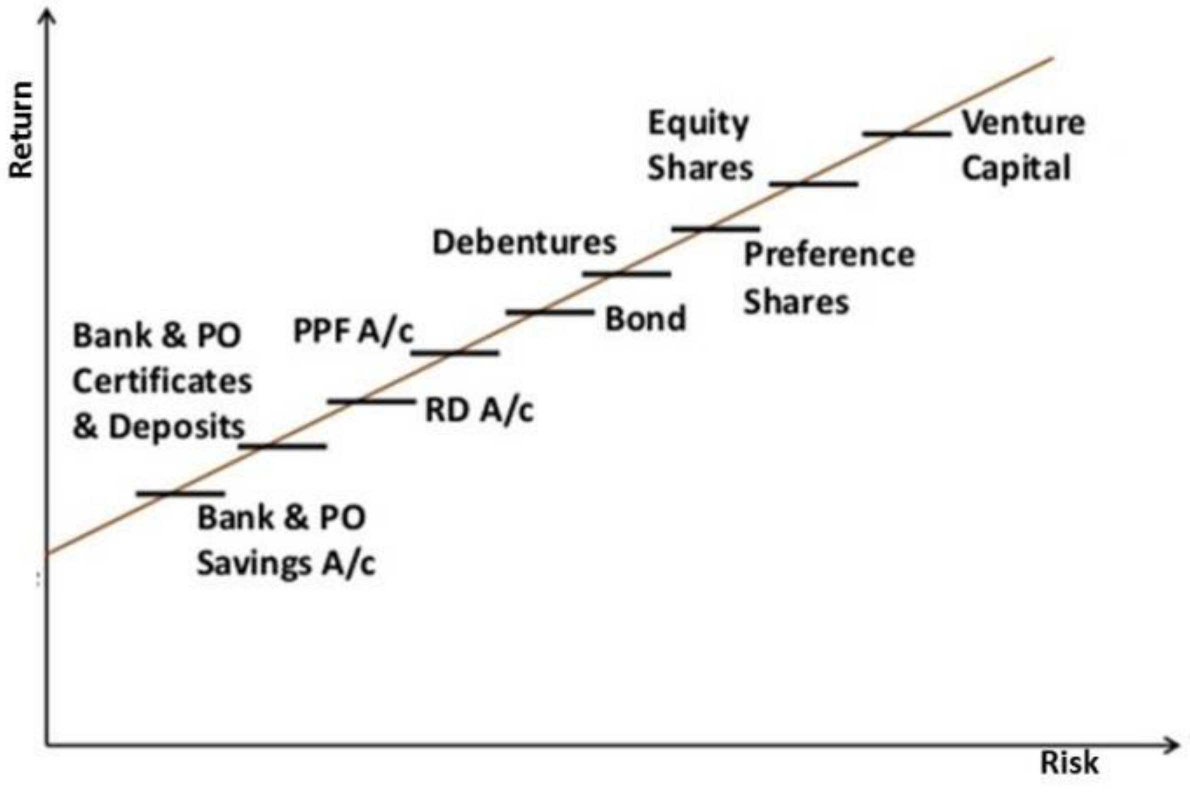
There is currently no annual or lifetime limit. This means you can contribute as much as you like, and the full amount will be tax deductible.

Is a Section 12J Investment risky?

There are inherent risks involved with any investment, particularly one made into a Venture Capital Fund. However, this risk can be mitigated if the fund manager invests in a diverse range of companies. Furthermore, there also needs to be a CA on the board of directors which will ensure that with any investment, the risk will be assessed and managed, there will be due diligence, and investment performance will be accurately reported.

The Risks Of Investing In A Section 12J VCC

Investing in a Venture Capital Company (VCC) does contain some risk, and it is considered riskier than a listed equity investment. The image below shows the theoretical risk versus return profile for various asset classes. A Venture Capital investment appears on the far right - it is a risky asset class, however greater returns can be expected. It is also important to note that in general there are two types of risk associated with a VCC investment. There is usual investment risk, but then there is also liquidity risk which investors should also be aware of.



Investment Risk

Venture Capital Companies are usually young companies and therefore not yet established. This means they carry a higher risk of failure compared to more mature businesses. However, some of this risk is mitigated by the income tax relief, since, in effect the capital invested is only a percentage of the face value of the investment.

Liquidity Risk

The current Section 12J legislation requires the VCC shares to be held for a period of 5 years to make the tax deduction permanent. This means that capital may be tied up while this holding period expires. But in addition to this, even after the holding period, it may not be easy to sell VCC shares at their full value as a willing buyer will need to be found. Purchasers of these "second-hand" VCC shares will not benefit from upfront income tax relief unless the proposal to transfer tax benefits is implemented.

Keep in mind, the beauty of Sunstone capital is that it is asset based which allows for higher liquidity on desire to exist and also mitigates a fair bit of the risk.