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TAX AND EXCHANGE CONTROL ALERT

IN THIS **ISSUE**

ARE WE SEEING MORE POSITIVE DEVELOPMENTS IN THE VENTURE CAPITAL COMPANIES REGIME?

On 15 June 2016 the South African Revenue Services (SARS) released Binding Private Ruling 242 (Ruling), which provides clarity on the interpretation and application of certain provisions of the Income Tax Act, No 58 of 1962 (Act) in the context of venture capital companies. Specifically, the Ruling deals with the interpretation and application of the terms "controlled group company", "equity share" and "hotel keeper", as defined in s1 of the Act, and the terms "qualifying company" and "qualifying share" as defined in s12J of the Act.

CUSTOMS AND EXCISE HIGHLIGHTS

This week's selected highlights in the Customs and Excise environment.

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CLIFFE DEKKER HOFMEYR

ARE WE SEEING MORE POSITIVE DEVELOPMENTS IN THE VENTURE CAPITAL COMPANIES REGIME?

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A VCC may be described as a company (similar to an investment holding company) that issues shares to an investor to raise capital, and applies the proceeds towards investing in other companies.

By way of background, the venture capital company (VCC) regime was introduced in 2009 and came into operation on 1 July 2009 by the introduction of s12J into the Act. The purpose of this regime was to encourage investors to invest their capital into the growth, development, and long-term sustenance of resident small and medium-sized enterprises, which would have had a lower growth or would not have been able to sustain their existence without funding, in exchange for certain tax benefits.

In essence, a VCC may be described as a company (similar to an investment holding company) that issues shares to an investor to raise capital, and applies the proceeds towards investing in other companies. Provided that various requirements are met, the investor may claim the amount invested in the VCC as a deduction from income. The deduction may be claimed up-front, and no recoupment will arise upon disposal if the share is held for more than five years. The VCC must be approved by SARS, and must make investments in qualifying companies.

In this case the Applicant (an approved VCC), together with two qualifying companies (Company One and Company Two) applied for a binding private ruling in respect of the following proposed transaction: Company One and Two intend to carry on the business of hotel keepers. Each of them will appoint a managing company to operate their hotels. The managing company would guarantee a certain EBITDA per year.

The Applicant intended to subscribe for A class ordinary shares in Company One. A co-investor would subscribe for B class ordinary shares in Company One.

The A class shares would be entitled every year to a distribution equal to the guaranteed EBITDA. The B class shares would be entitled to a distribution of the remaining profits.

Upon an exit the A and B class shares will carry a right to a return of capital plus a cumulative compound return. The A class shares will rank ahead of the B class shares in respect of these returns, after which they will rank *pari passu*.

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CONTINUED

Company One and Two will each carry on the business of a "hotel keeper", through the agency of the managing company, and could claim specified allowances in terms of s12C(1)(d) of the Act.

Company One will use the amounts invested by the Applicant to purchase sectional title hotel rooms, together with undivided interests in the common areas. Company One will have an option to purchase, within four months of the initial purchase, further units financed with third party debt. The aggregate purchase consideration in respect of the initial purchase and further purchase will exceed R50 million. As part of the purchase, the seller will cede its rights and obligations in respect of a hotel managing contract to Company One.

The Applicant will also subscribe for A and B class ordinary shares in Company Two. The rights attaching to the shares will be similar to the rights attaching to the shares in Company One.

Company Two will use the amounts invested to purchase new developed sectional title rooms from a property developer and accompanying undivided interests in common areas. A hotel managing company will be appointed and will be paid a management fee.

The Applicant intends to exit the investment on or before the fifth anniversary. Company One and Two also intend to sell their respective hotel businesses and distribute the proceeds to the shareholders.

SARS ruled as follows:

- the shares issued to the Applicant by Company One and Two would constitute qualifying shares as defined in s12J(1) of the Act;
- Company One and Two would not be disqualified as qualified companies as defined in s12J(1) of the Act because they would not constitute a controlled group of companies. This is so because the number of equity shares held by the Applicant in Company One and Two would constitute less than 70% of the total number of the issued equity shares, despite the fact that the Applicant will contribute more than 70% of the total share capital investment in each of Company One and Two;
- the option to acquire additional sectional title units granted to Company One and the right to exercise such option immediately after the issue and initial purchase of the sectional title units would not bring the Applicant within the ambit of s12j(6A)(b)(ii) as a ground for disqualification as a VCC. The said section provides that SARS may withdraw a VCC's approval if after three years of the issue of venture capital shares by that VCC, less than 80% of acquisition expenditure was incurred to acquire qualifying shares in qualifying companies that held assets with a book value of less than R50 million; and
- Company One and Two will each carry on the business of a "hotel keeper", through the agency of the managing company, and could claim specified allowances in terms of s12C(1)(d) of the Act.

Mark Morgan, Gigi Nyanin and Heinrich Louw

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CUSTOMS AND EXCISE HIGHLIGHTS

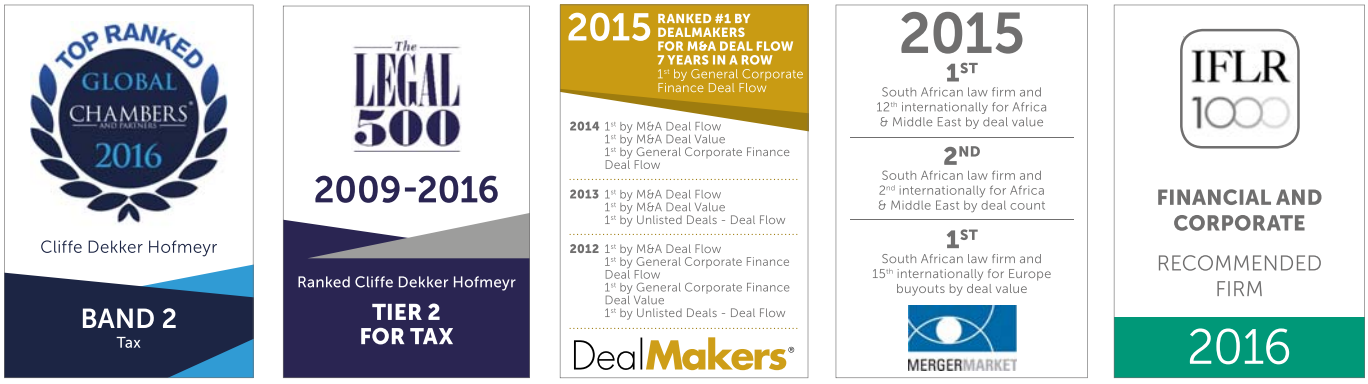
Please note that this is not intended to be a comprehensive study or list of the amendments, changes and the like in the Customs and Excise environment, but merely selected highlights which may be of interest.

In the event that specific advice is required, kindly contact our Customs and Excise specialist, Director, Petr Erasmus.

This week's selected highlights in the Customs and Excise environment:

- Amendment of Schedule 2 of the Customs and Excise Act, No 91 of 1964 (Act) by inserting item 204.05, TH200410.2 – "Chips or French fries" imported from or originating in Belgium and the Netherlands.
- Amendment of Rule 64D of the Act relating to removals of goods in bond.
- Amendment of Schedule 1 Part 1, its Notes and Schedule 10 and insertion of Rule 49E of the Act to give effect to the implementation of the preferential trade agreement between MERCOSUR and SACU (with retrospective effect from 1 April 2016).

Petr Erasmus



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