BIZCOMMUNITY

Treasury's decision to cancel S12J investments - throwing the baby out with the bathwater

By Dino Zuccollo

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In the 2021 Budget Review tabled with finance minister, Tito Mboweni's budget speech, Treasury announced that Section 12J of the Income Tax Act will not be extended past its sunset date of 30 June 2021. Parliament is now faced with the decision whether to accept Treasury's policy and not extend Section 12J, or take an alternative course of action.

Dino Zuccollo is the chair of the 12J Association

One of Treasury's primary objections to Section 12J is that the majority of investments supported by the incentive are in what it believes to be "low-risk" or "guaranteed-return ventures" that would have been able to attract funding even without the incentive. This objection seems to relate primarily to property-backed businesses like hotels (whose operations are backed by real estate assets) and asset rental businesses (where risk tends to be mitigated through astute corporate structuring). Since Treasury perceives these businesses as less risky, the view is that they already have easy access to equity capital.

However, the Covid-19 pandemic has highlighted that this view is not correct. Hotels and tourism, for example, have been decimated by the pandemic and have certainly not enjoyed easy access to equity capital over the past year.

Similarly, many of the SMMEs that managed to navigate their way through the pandemic will attribute the resilience of their businesses to the existence of an understanding equity provider who continued to provide them with funding at times when all traditional sources of capital had dried up. These equity providers often take the form of Section 12J asset rental structures, providing patient equity capital to SMMEs at a time when they need it most.

Creating jobs

It should also be highlighted that many South African investors perceive any onshore investment to be risky, especially given our current economic climate and even more so when investing in new, small businesses. The perceived risk of investing locally is the reason why capital flight is exceptionally high at this present time.

The Section 12J tax incentive, which was introduced by government with a view to creating jobs and developing small businesses, is an ideal mechanism to help stem capital flight because it incentivises investors to keep their money in the country. This money is then invested in small and medium sized business that help grow the economy and create jobs for a minimum period of five years.

Our concern is that the ending of the 12J incentive will precipitate and accelerate the flight of capital out of South Africa. We simply cannot understand the rationale for cancelling one of the few mechanisms available to convince high net worth individuals to invest long-term capital in South Africa and grow our tax base at a time when capital flight is one of the key economic risks to the country.

Most investments in last two years

Treasury’s view that Section 12J’s economic impact has been limited seems to be based on anecdotal evidence over a short period of time. It should be noted that the Section 12J legislation only gained traction following changes to the law in 2016, and as such the majority of 12J investments were made in the past two years.

This is far too short a period of time to gauge the resultant impact which these investments have had on SMMEs, which, on average, take at least three to five years to become profitable, grow, and begin employing more people. We believe that the legislation needs to be given more time to operate before any reliable claims can be made about its likely economic impact and consequential decisions be taken regarding the future.

Even so, on Treasury’s own conservative statistics, qualifying companies have created 8,239 jobs in a remarkably short space of time, and during a recession. Our research shows that, if the 12J incentive was allowed to continue to operate, up to 45,000 jobs would be created in the next five years.

We stand by our view that the Section 12J incentive has been extremely beneficial for the South African economy. By revoking the 12J incentive, Treasury is effectively inviting investors to put their money elsewhere (in a different asset class, currency or even country).

The 12J Association certainly does acknowledge that the incentive could be targeted better to ensure that only investments which Treasury deems economically beneficial will qualify for a tax deduction. This is something that we could support, and we are open to engaging further with Treasury and Parliament on how this could be structured.

Profound mistake

It would be a profound mistake, however, for the 12J incentive to be summarily removed from the statute books when it has so much to offer in terms of investment, growth and job creation. If there are unintended consequences of the legislation as it is currently, let’s fix these problems so that everybody benefits. It makes little sense to throw the baby out with the bathwater — especially as we begin the rebuild of our economy following the Covid-19 pandemic.

We will seek to engage further with Treasury on its announcement regarding Section 12J of the Income tax Act, and we hope to take our case to Parliament as it deliberates on the draft revenue bills tabled by the minister. Our goal is to ensure that the 12J incentive’s economic benefits are maximised, and that South African capital is invested in South African projects.

ABOUT THE AUTHOR

[[https://www.linkedin.com/in/dino-zuccollo-ca-sa-mcom-3616247a/?originalSubdomain=za Dino Zuccollo]] is the chair of the 12J Association