BIZCOMMUNITY

5 aspects of 12J investments you may be myth-ing

By Andrew Friedman

9 Feb 2021

"Too good to be true" is an adage that typically services you well when it comes to your money, especially in a world full of myths and conspiracy theories, Ponzi deals, pyramid schemes and promises of the Next Big Thing. As such investors are - rightfully so - reluctant to participate in alternative investments but for those in the know, in financial circles, myths aside, the Section 12J tax incentive is proving to not only be an excellent investment opportunity, but as we near closer to our annual tax year-end, it's clearly gaining popularity as a well-informed solution to a heavy tax burden.

Andrew Friedman, head of sales, Anuva Investments

Section 12J of the Income Tax Act which was introduced in 2009, allows an investor to deduct the full amount invested in a Section 12J VCC from taxable income for the specific year. Simply put, the South African Revenue Services' (Sars) section 12J incentive enables taxpayers to invest in South African companies instead of paying income tax.

Putting it under the investment microscope, has 12J just been unfairly judged or are investors simply myth-ing the point? Let’s clear up a few myths about Section 12J:

1. Section 12J is not legislated

Section 12J investments were first introduced by the Sars, on instruction from National Treasury, in 2009. The tax incentive was created through Section 12J of the Income Tax Act 1962 with the purpose of stimulating economic growth, creating jobs and as a catalyst for equity funding for SMEs. A Section 12J VCC is registered as financial servicepProvider (FSP) with the Financial Sector Conduct Authority (FSCA) and is approved by the Sars. All information regarding 12J can also be verified by Sars or any senior tax advocate.

2. Section 12J investments are only for the super wealthy

This is an extraordinary opportunity for any South African tax payer. The minimum investment amount is fund-specific, but an individual investor may invest up to R2.5m, and a company/trust up to R5m in any given tax year. Some 12J VCCs also offer finance options in the way of debt funding, partnerships or bonds for qualifying individuals or companies.

3. Investing in a Section 12J fund is high risk

There is risk in any investment; however, in this instance, the only risk is that although you save up to 45% in marginal taxes, the underlying investments need to perform adequately for you to realise those savings and additional profitable growth.

4. The sectors into which a Section 12J VCC can make investments are limited

Section 12J of the Income Tax Act allows Section 12J VCCs to invest in most industries, although some are prohibited, for example immovable property (excluding the hospitality sector, e.g. hotels, B&Bs), financial and advisory services sectors, trade being carried on in respect of gambling, tobacco, liquor, and trade being carried on outside the republic.

5. There is no exit strategy for Section 12J investments and you will lose all your money

There are numerous options that will allow an investor to realise his/her investment in a Section 12J VCC. Some of the more common options are to sell the shares to a third party, or the Section 12J VCC acquires the shares from the investor from the proceeds on the disposal of the underlying investment.

It is essential to understand that to avoid a full recoupment of your tax deduction, funds must remain invested for five years. Additionally, the investment is of your taxable income, not tax due. However, if the investor disposes of his/her shares before the five-year period, the initial investment amount will be recouped, and the investor will be required to pay back the full tax saving with no additional interest or penalties. Also, while the investor’s base cost for capital gains tax (CGT) purposes will be zero when the investor exits the Section 12J VCC, an investor could potentially pay CGT on the initial investment plus growth on the investment.

Sunset clause

The Section 12J incentive may soon end as a result of a ‘sunset clause’ in the Income Tax Act which makes provision for such investments only until 30 June 2021. The industry is pushing for the sunset clause to be extended for another five years in order to boost local investor confidence but it’s not a given. Fact is, now is the time to take advantage of the government’s generous 12J tax break that is setting investment circles abuzz - it’s a well-established, reputable investment tool that has already seen over R10 billion invested by South African taxpayers to date – nothing mythical about it.

ABOUT THE AUTHOR

Andrew Friedman is the head of sales at Anuva Investments.