EXPLANATORY MEMORANDUM ON SECTION 12(J) OF THE INCOME TAX ACT

The VCC is intended to be a marketing vehicle that will attract retail investors. It has the benefit of bringing together small investors as well as concentrating investment expertise in favour of the small business sector. As from 1 July 2009, any taxpayer can claim tax deductions to the full amount invested into these specific VCC shares.

TAX BENEFITS

Section 12J came into effect on the 1st of July 2009 and was created specifically for the purpose of inviting investors to participate in the capitalisation of promising small and medium sized qualified enterprises in the Republic of South Africa.

Taxpayers who invest in a VCC, through the acquisition of shares in the VCC, are entitled to a 100% tax deduction on monies invested, subject to the provisions of Section 12J, thereby achieving an immediate return of up to 45% (being the reduction in taxes payable) on their investment.

EXAMPLE: Tax benefit of a R10 000 000 investment is shown below:

DESCRIPTION	INDIVIDUALS	TRUSTS	COMPANIES
Initial Investment	R10 000 000	R10 000 000	R10 000 000
Effective Tax Rate	45%	45%	28%
Tax Relief (In the financial year of initial investment)	(R4 500 000)	(R4 500 000)	(R2 800 000)
Net cost of investment	R5 500 000	R5 500 000	R7 200 000

NOTE: This illustration assumes that the individual or trust falls entirely in the 45% income tax bracket.

SUMMARY

INDIVIDUALS

A R10 000 000 investment will cost a taxpayer R5 500 000.

The taxpayer would have paid R4 500 000 in tax.

TRUSTS

A R10 000 000 investment will cost a taxpayer R5 500 000.

The taxpayer would have paid R4 500 000 in tax.

COMPANIES

A R10 000 000 investment will cost a taxpayer R7 200 000.

The taxpayer would have paid R2 800 000 in tax.

FAIRTREE CAPITAL

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GOVERNING LEGISLATION

Section 12J is subject to the provisions of the Income Tax Act. Section 12J was introduced to cater for the deductions in respect of expenditure incurred in exchange for the issue of VCC shares.

HOW DOES SECTION 12J WORK?

Taxpayers will invest in approved VCCs in exchange for the issue of VCC shares and a VCC Investor Certificate. Investors can claim tax deductions in respect of their investments in an approved VCC. The VCC Investor Certificate will provide SARS with the proof it needs to allow the Investor the relevant tax deduction.

The approved VCC will, in turn, invest in Qualifying Companies in exchange for Qualifying Shares.

TAXPAYER CRITERIA

Any South African registered taxpayer qualifies to invest in an approved VCC. Taxpayers can claim income tax deductions in respect of the expenditure actually incurred to acquire shares in approved VCCs.

Where any loan or credit is used to finance the expenditure in acquiring a VCC share and remains owing at the end of the year of assessment, the deduction is limited to the amount for which the taxpayer is deemed to be at risk on the last day of the year of assessment.

No deduction will be allowed where the taxpayer is a Connected Person (i.e. someone holding more than 20% of the issued share capital of the VCC).

On request from SARS, the taxpayer must verify a claim for a deduction by providing a VCC Investor Certificate that has been issued by an approved VCC, stating the amount of the investment and the year of assessment in which the investment was made.

Except in the case of VCC shares held by a taxpayer for longer than five years, the deduction is recouped (recovered) if the taxpayer disposes of the VCC shares to the extent of the initial VCC investment (under the general recoupment rules of Section 8(4) of the Income Tax Act).

Standard income tax and capital gains tax rules apply in respect of VCC shares.

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QUALIFYING COMPANY CRITERIA

A company is eligible for investment by a VCC if:

- the company is resident in South Africa;
- the company is not a controlled group company in relation to a group of companies;
- the company's tax affairs are in order (a tax clearance certificate must be requested from SARS to support this requirement);
- the company is an unlisted company; and
- during any year of assessment, the investment income, as defined in Section 12E(4)(c) of the Income Tax Act, does not exceed 20% of its gross income for that year.

The company must not carry on any of the following impermissible trades:

- Any trade carried on in respect of immoveable property, except trade as a hotel keeper (includes bed and breakfast establishments);
- Financial services activities such as banking, insurance, money-lending and hire purchase financing;
- Provision of financial or advisory services, including legal, tax advisory, stock broking, management consulting, auditing, or accounting;
- Operating casino's or other gambling related activities including any other games of chance;
- Manufacturing, buying or selling liquor, tobacco products or arms or ammunition; or
- Any trade carried on mainly outside the Republic of South Africa.

There are no special tax rules for investee companies. The standard tax rules will apply.

SECTION 12J COMPANIES REQUIREMENTS

The Company must satisfy the following requirements by the end of each year of assessment after the expiry of 36 months from the first date of issue of VCC shares:

- A minimum of 80% of the expenditure incurred by the VCC to acquire assets must be for Qualifying Shares, and each Qualifying Company must, immediately after the issuing of the Qualifying Shares, hold assets with a book value not exceeding R50 million.
- The expenditure incurred by the VCC to acquire Qualifying Shares in any one Qualifying Company must not exceed 20% of any amounts received in respect of the issue of VCC shares.

RESPONSIBILITIES OF VENTURE CAPITAL COMPANY

- The VCC must maintain a record of all its investors. A copy of this record must be submitted to SARS in February and August of each year and to the FSB as and when investors change.
- The VCC must maintain a record of all its investments. A copy of this record must be submitted to SARS in February and August of each year.
- The onus will be on the VCC to ensure that it invests in Qualifying Companies that meet the stipulated requirements.
- The VCC must issue VCC Investor Certificates to its investors in the year in which the investment is received.
- On request from the Minister of Finance, a VCC must submit a report providing information that the Minister of Finance may prescribe.

STEP-BY-STEP SUMMARY

- 1 -

Qualified investor invests into SARS registered 12J Company.

- 2 -

VCC Company issues shares and investor certificate.

- 3 -

Investor receives 100% tax deduction in year of investment.

- 4 -

Fairtree Capital Hospitality invests in qualifying investee companies.

- 5 -

The investee company issue shares to Fairtree Capital Hospitality.