

22 August 2014

Attention: Mr. Allan Wicomb

VIA E-MAIL: awicomb@parliament.gov.za

Dear Mr Wicomb,

RE: TAXATION LAWS AMENDMENT BILL, 2014: SMALL BUSINESS FUNDING ENTITIES

This submission pertains to the newly proposed "small business funding entity" dispensation contained in the Taxation Laws Amendment Bill, 2014.

1. Foundation objectives

- 1.1. The SAB Foundation Trust Deed (2011) states the primary objective as *"to contribute to the economic and social empowerment of historically disadvantaged communities through Community Development, primarily (but not necessarily exclusively) by means of Entrepreneurship Development and with a priority focus on benefitting women and youth in rural areas, as well as persons with disabilities"*
- 1.2. In terms of our activities, we as the SAB Foundation have long been involved in the funding of small and micro business for young black entrepreneurs that lack alternative means to capital. In terms of our funding, we have two grant programmes. We provide social innovation awards for young entrepreneurs with unique business products or services that will have a demonstrable social and economic impact in areas of poverty alleviation and/or improvement in quality of life and/or prosperity.
- 1.3. We also provide funding for small and micro-businesses with our funding acting as "seed capital" to initiate or to accelerate the growth of these businesses. All funding is effectively in-kind (with the SAB Foundation purchasing business equipment on behalf of the small/micro business).
- 1.4. At the present time, our work is dedicated to choosing appropriate beneficiaries and ensuring that the funding is properly allocated to businesses that will stimulate domestic small and micro-business growth as envisioned. We plan to further provide training to these businesses. However, true to our history, this training will be without compensation. Our programmes have the sole objective of providing funding without compensation or any other indirect strings attached.

2. Overall comments

- 2.1. As an initial matter, we are delighted with National Treasury's efforts in this area. After having made repeated unsuccessful attempts over the years to have the SAB Foundation recognized as a public benefit organization, the concept of a small business funding entity goes a long way towards satisfying our needs.
- 2.2. Our sole tax objective is to receive or accrue tax-free revenues so that these revenues can be fully passed onto small and micro business beneficiaries (without any reduction for tax).
- 2.3. This goal appears to be at the heart of the proposed small business funding initiative because it is understood that the lack of "seed capital" is often the most significant obstacle in the way of small business growth.
- 2.4. Nonetheless, despite our general support, we believe that the proposal can be modified slightly for more enhanced use. Whilst the initial entry requirements are almost exactly on point, a few technical issues exist that may cause unintentional hurdles. In addition, the exemptions afforded seem to be missing some important elements.

3. Entry requirements: Technical issues

Issue 1: Widely accessible requirement

- 3.1. Proposed section 30C(1)(b)(ii)(aa) requires entity funding to be "widely accessible to all small, medium and micro-enterprises." (Emphasis added.) The literal term "all" creates an obvious technical problem because any funding organization will utilise criteria when dispensing grants. These criteria could be sector based (e.g. limiting grants to agriculture, mineral beneficiation etc...), geographically based, population based or even business viability-based. As you are aware from our prior submissions, the SAB Foundation mainly targets the younger black African portion of the population with special emphasis on benefitting women and youth in rural areas, as well as persons with disabilities. The SAB Foundation also has criteria to ensure viability.

Recommendation: We request that the word "all" be dropped. The incentive should instead be accessible to the general public or a reasonable segment thereof.

Issue 2: The 25-per cent distribution requirement

- 3.2 Proposed section 30C(1)(d)(vi) requires recurring annual distributions (or obligations to distribute) of 25 per cent of all amounts received or accrued. The technical question is one of timing. The 25 per cent test literally applies all "amounts received or accrued in respect of assets held . . . during any year of assessment." (emphasis added) Must this test be applied in respect of all amounts received or accrued over the prior years of assessment or simply in respect of the current year? We believe that the latter

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interpretation represents the probable intention but the word “any” is problematic.

- 3.3 In terms of the SAB Foundation, the funds distributed (or the incurral to distribute) are generally in relation to the full amount received or accrued during the assessment year. The SAB Foundation has consistently exceeded this 25 per cent annual percentage of receipts or accruals for the year. On the other hand, the SAB Foundation would resist distributing the corpus of its investment assets (25 per cent of receipts or accruals received or accrued to-date) because the loss of corpus would inevitably make the SAB Foundation unsustainable. We also that believe that forced distributions of underlying corpus violates the policy of the small business funding entity exemption. The proposed tax relief for fundraising is not intended to cover recurring annual contribution fund drives (proposed section 10(1)(cQ)(ii)), which would be required to replace the corpus once depleted.

Recommendation: We would propose that the 25 per cent test be limited to the year of assessment in which the receipt or accrual arises.

Issue 3: Listed shares

- 3.4 Proposed section 30C(1)(d)(ix) prevents cross-holdings in other business, professions or occupations other than the holding of listed company shares. This exclusion of cross-holdings presumably ensures that the funding entity is completely separate from its grant beneficiaries. Holdings in listed shares are seemingly independent from the small business funding entity due to the large number of shares and the relatively insignificant probable ownership involved.
- 3.5 The exclusion is appreciated, but the SAB Foundation only has a minority holding in the shares of South African (South African Breweries Pty Ltd), a controlled subsidiary of a U.K. entity listed on the London Stock Exchange (SAB Miller PLC). The shares of South African Breweries Pty Ltd are accordingly not listed. This ownership in a local South African company is consistent with the special Exchange Control dispensation granted to the SAB Miller group many years ago.

Recommendation: The shares of a controlled subsidiary should be permissible because the SAB Foundation has nothing more than a passive minority ownership interest in the controlled subsidiary.

4. Scope of Exemptions

Issue 1: Absence of Specific Relief for Passive income

- 4.1 The exemptions available for small business funding entities are similar to the exemptions for public benefit organisations. One notable difference is the lack of any specific exemption for passive income (receipts/accruals derived “otherwise than from any business undertaking or trading activity” (section 10(cN(i))). Passive income can only be exempt to the extent of the

greater of: (i) 5 per cent of total receipts and accruals, or (ii) R200 000 (proposed section 10(1)(cO)).

- 4.2 We fail to understand the logic of taxing passive income versus exempting active income nor can any justification be found in the Explanatory Memorandum. The SAB Foundation regularly distributes its passive income as indicated above. If concerns exist that excessive passive funds will be stored within the entity, one can increase the distribution requirement from the current 25 per cent level to a 50 percent level (so as to match the new rules for public benefit organization funding entities). Otherwise, we very much fail to understand the perceived abuse that can arise in respect of these entities (because the provision already has a general anti-avoidance rule built into the small business constitution and the types of shareholdings have been severely limited).

Recommendation: The passive income exemption for public benefit organisations (section 10(cN)(i)) should similarly be allowed in the case of small business funding entities,.

Alternative recommendations: If for some reason trading income is preferred as a policy matter, the 5 per cent threshold should at least be increased to 10 per cent as a form of working business capital exemption. Alternatively, a special exemption could exist for bank deposit interest because short-term passive holdings will regularly be maintained in these accounts for disbursement of funds.

Issue 2: Lack of capital gains tax relief

- 4.3 Unlike public benefit organisations, no capital gains tax relief exists for the disposal of assets by small business funding entities. This lack of relief from the capital gains tax is hard to justify, especially in the case of listed shares (which can be held) and which are already exempt from Dividends Tax (see proposed section 64F(1)(i)). Capital gains in respect of these shares are theoretically nothing more than built-up prior dividends and/or expected future dividends.


Recommendation: Capital gains should be exempt from the taxation of small business funding entities. This exemption should match the exemption for public benefit organisations (see paragraph 63A of the Eighth Schedule).

Alternative Recommendation: We note that the SAB Foundation is in a unique situation. In the next several years, the SAB Foundation will be required to exchange its shares in South African Breweries Pty Ltd for the shares of the listed U.K. holding company (SAB Miller PLC). This conversion will not be free of tax because section 42 does not apply to the exchange of domestic shares for foreign shares. We would accordingly request that small business funding entities be allowed to obtain section 42 rollover relief for their share-for-share exchanges even if the shares received will be foreign.

5. Summary

We would again like to thank you for advancing this topic so we can enhance South Africa's entrepreneurial empowerment funding. We believe that the above adjustments will remove the final tax barriers that have burdened this project for so long. We are more than happy to meet or otherwise engage in respect of any further questions that you may have.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Hema Moodley', written over a horizontal line.

Hema Moodley
Group Tax Manager