SUBMISSION TO TREASURY IN RESPONSE TO TAXATION LAWS AMENDMENT BILL (TLAB) 2019

CONFIDENTIAL

12Cape is a Section 12J Venture Capital Company which invests in tourism, specifically in the City of Cape Town, a major international tourist attraction. In this document we demonstrate the effectiveness of the S12J incentive as a mechanism which:

(1) **Shepherds private savings to tourism infrastructure** by incentivising owners of private South African capital to invest in South Africa, specifically in South African Tourism capacity, as opposed to taking their capital out of the country[1]

(2) **"Captures the Opportunity":** It is only with (1) that South Africa will be in a position to capture the opportunity and keep up with global growth in tourism

(3) **"Grows the Pie":** With (2), capture the large, growing surplus which was generated elsewhere and which is voluntarily brought to South Africa by international tourists

(4) **"Shares the Pie"**: We will demonstrate the financial and social return on investment for the Government, for the unemployed (who become employed), and for owners of private capital via the S12J incentive, and the fairness and sustainability of the distribution from a risk and return perspective.

Both the Western Cape and national governments have a stated objective to double tourism in their respective jurisdictions, for good reason: Tourism provides an attractive and long-term hard-currency externally funded solution to the high number of unskilled and unemployed people of our Country. The sector is responsible for 1 in 10 jobs globally[2] where it fosters acceptance and tolerance and will continue its growth trajectory for decades[3]. Given the natural

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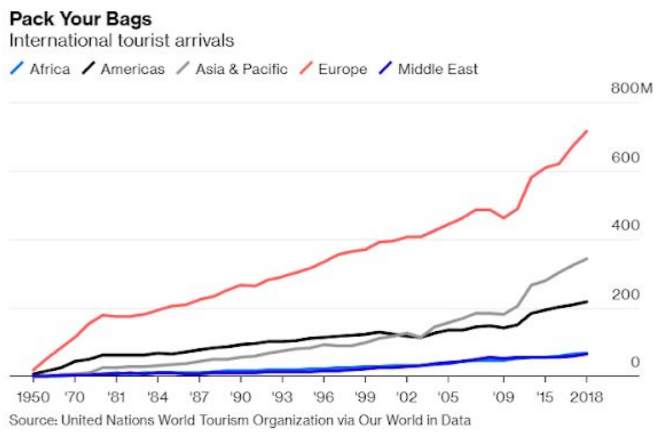
[1] The biggest reason cited by investors for declining to invest in 12Cape is that they want to "rather take their savings offshore"

[2] https://www.bloomberg.com/opinion/articles/2019-08-12/tourism-is-overwhelming-the-world-s-top-destinations

[3] Supported by advances in Technology, growing emerging market middle classes, ageing in developed markets and consumer preferences for "experiences" in the younger demographic

heritage of South Africa, our shared timeline with Europe and friendly people, South Africa deserves to be part of this growth trend for the long term.

It stands to reason that doubling tourism in South Africa can only happen if there is a significant increase in our capacity to host tourists who intend to visit our shores. It is therefore of paramount importance to create tourist accommodation capacity, and to incentivise the creation of same where possible - specifically as per the promulgated 12J allowance for the express creation of hotelkeeping capacity. Our analysis shows that Cape Town, a major tourist attraction where international tourist arrivals have been growing at 10% per year for the last 5 years, will have a severe shortage of international tourist accommodation in the short to medium term[4] despite the rapid growth of Airbnb and similar home sharing platforms, hence our focus on this specific area.



Problems addressed: High unemployment in South Africa[5]. Capital Flight from South Africa[6]. Low tax revenues[7]. Low growth in weak rand environment[8]. Deficit of tourist accommodation in South Africa[9].

Every R50m[10] raised by 12Cape is invested into a Qualifying Company which trades as a Hotelkeeper[11] in Cape Town of which c. 14% is allocated to locally manufactured furnishing and art, and the remainder to a total of 16 newly built double rooms. The sole focus of the hotelkeeper is to be a proudly local[12], and a world class host to international tourists. It is assumed that the property gains value over time (10% p.a.) while the furnishing and art depreciates fully over the period, and is replaced, hence an exit asset value of R76m which is sold after 5 years.

[4] Despite the growth in "airbnb" and similar home sharing platforms, of which the analysis we can share with you confidentially
[5] Up to 30% unemployment in South Africa
[6] Currently estimated to be c. R420m per day from the JSE
[7] Budget deficit of c. R14bn in 2018
[8] Estimated between 1% and 2% in 2019
[9] Government objective to double tourism over the next ten years not currently matched with capex
[10] Maximum investment per Qualifying Company, of which there will be at least 5
[11] As defined by the Income Tax Act, and specifically targeting foreign tourists
[12] The brand, "Latitude", focuses on world class local tourist experiences with the tagline "Live Local"

Assuming an average occupancy rate of 80%[13], an average length of stay of 8 days[14], total bookings per annum for the hotelkeeper will equate to 584, or at 1.5 tourists per room 4,380 foreign tourists hosted over the five year period.

Taxable Revenues in the Hotel: At an average rack rate per room of R1,200 (in the target area, throughout the season, without inflation), taxable hotelkeeping revenues will amount to R28m over the period, of which taxable hotelkeeping services amount to R16.8m, and of which the post-tax remainder is distributed to investors as dividends subject to dividend taxes.

Taxable Revenues outside the Hotel: Internationally, it is accepted that tourists spend as much on their accommodation as they do on entertainment outside the hotelkeeper[15]. A quick sense check shows, this analysis is conservative: If 1.5 tourists spend R1,200 on their room, any given tourist should spend R800 on entertainment: Perhaps R150 for lunch, R200 for dinner, R100 for travel and R350 for experiences (a return ticket on the cable car costs R180). Hence: Total taxable guest spending outside the hotel over the period of R28m over the period.

Total Taxable Tourism Revenues: The original investment of R50m therefore catalyses an amount of R56m of Total Foreign Tourist spend in South Africa, which amounts to direct foreign currency investment in our economy over a five year period.

Total Tax Revenues over the period: Total dividend tax amounts to R2.2m, Corporate taxes on Guest spending amount to R15.6m, Capital Gains Taxes due by the Fund of R5.8m, Capital Gains Taxes due by Investors at Exit[16] to R9m, for a total tax revenue catalysed of R32.8m, which is in excess of the initial R22.5m tax benefit[17] granted. The actual trade-off will be more attractive given lower average tax rates of the broader investor base.

Job Creation: According to Wesgro, a sustainable increment of 12 foreign tourists[18] creates one sustainable domestic job. Using the tourist spend guidelines above, we know that our 12 foreign tourists could easily spend up to R19,200[19] in total per day, which amounts to 80 jobs at the minimum wage (hence, enough foreign currency available to compensate labour), and we also know that hosting 12 foreign international tourists for any given day is likely to keep more than 1 person busy on a full time basis (hence, enough demand to justify this number). Using the conservative 12 tourists to 1 job ratio (which could easily be 12 tourists to 2 or 3 jobs based on the analysis above), the cumulative 4,380 tourists will be responsible for creating 365 job

[13] Comparable asset occupancy of 80% during water crisis and longer term
[14] Per Wesgro guidance, average length of stay in Western Cape 12 days, per Totalstay who run an Aparthotel, 4 days. We take the average
[15] Airbnb Research
[16] Zero based
[17] Conservatively using the maximum benefit of 45% as opposed to an average which is much lower.
[18] Also per former Min. Derek Hanekom's speech
[19] 12 x ((R1,200 / 1.5) + R800)

years[20]. This is in addition to the c. 400 job years created in the construction phase of the building, and c. 40 job years in the local furnishing and local art (including its maintenance) over the period. A grand total therefore of 805 job years, over the five year period, catalysed by the R22.5m incentive over and above the financial benefits described above. Given the structural nature of global tourism trends, it is likely that the tourism related employment would become permanent (e.g. the investment catalysed permanent employment and should be amortised over a lifetime of permanent working opportunities).

Win-Win: Over a five year period, National Treasury effectively invested R22.5m (in the form of a tax allowance) to attract 4,380 international tourists and catalyse 805 job years in the first five years only. From a fiscal perspective, the R56m of foreign direct investment in South Africa in addition to R32.8m of Tax Revenue yields a financial surplus of R66.3m, three times[21] its initial investment over five or six years (assuming the liquidation of assets happen after the mandatory five year holding period).

While the incentive seems generous, it and other incentives are **essential** if our country wants to expedite the creation of tourism infrastructure and thus to share in the growth of the global tourism pie. Our experience has been that it remains very difficult to convince investors with liquid investable capital to commit their capital to an illiquid investment in hotelkeeping property in South Africa[22] over their alternative international options.

Section 12J "Hotelkeeping" funds might not represent the classic "risk-return trade-offs"[23] expected from traditional Venture Capital[24] investments (which also have benefits), they are generally far more effective in promoting not only tourism, but more importantly job creation and foreign currency earnings which our country desperately needs.

As shown above, these vehicles present a mechanism which allows the government, the unemployed and the investor to share in a large surplus generated offshore and voluntarily brought to South Africa by international tourists.

Proposed Changes to S12J: The cost of managing and administering a section 12J fund is high, and working with other people's savings is a big responsibility. It will require at least 3 professionals to do it well, and therefore scale of at least R250m[25] to present a better employment alternative than professional jobs at traditional institutions. Achieving this type of

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[20] Defined as 12 months of work for one person to differentiate between construction jobs (a lot over one or two years only) and tourism jobs (spread over 5 years).
[21] More, in the case of lower average tax rates (hence lower tax benefit to investors) at investment date
[22] More information and demonstration available from large institutions
[23] E.g. High risk and low success rate, but where successes make up for many loss making investments
[24] E.g. startup companies, technology etc.
[25] At a 2% "asset management fee" in line with Private Equity and Hedge Funds, total revenues of R5m of which each professional will earn R1m (a large discount to professional alternatives in the asset management space), and of which R2m will be spent on rent, administration, regulation, legal work and capital raising (especially marketing and travel).

scale is not easy: While the incentive seems generous, it is already very difficult to convince investors with liquid investable capital to commit it to an illiquid investment in hotelkeeping property in South Africa. Where investors are willing to do so, they will reduce their risk by making a small allocation of 5%-10% of their liquid savings. S12J Fund managers generally take career and financial risk to establish a S12J Fund based on a long term business model to achieve scale in a stable regulatory environment. Previously, it was theoretically possible to achieve scale with 5 investors who committed R50m each, without the burden of becoming a public company. The proposed cap has increased the cost and administrative burden by at least 20x[26] as a result of a potential minimum requirement of a 100 investors to achieve a sustainable size.

It is for this reason, and the major benefits and positive externalities resulting from S12J hospitality funds, that we ask the National Treasury to continue to bolster investor confidence by addressing abuse where it occurs, and to review their position on the proposed changes to the Bill in favour of a stable regulatory framework which will enhance long term planning.

Problems Solved: High unemployment in South Africa via increased tourism. Increased Tourism via Increased Capacity to hosts Tourists. Less net capital flight from South Africa via increased tourism receipts and incentivising HNW[27] to invest in South Africa. Low tax revenues bolstered by international tourism spend. Low growth in weak rand environment bolstered by enhanced tourism in times of a weak rand.

[26] 100 investors / 5 investors = 20 X
[27] High Net Worth Investors