

Policy reforms key to enabling environment for entrepreneurs

Faster economic growth requires determined implementation of policy reforms to promote confidence, investment, competitiveness, entrepreneurship and job creation. This is according to the recently delivered Medium Term Budget Policy Statement.



Source: www.pexels.com

With this in mind, Matsi Modise, chairperson of the South African Startup Act Steering Committee and vice chairperson of SiMODiSA, together with Steering Committee members Tanya van Lill and Shelley Lotz from the Southern African Venture Capital and Private Equity Association (SAVCA), reflect on the policy changes that took place over 2021 and what can be expected in 2022.

Lotz shares that 2021 saw two changes to the policy that have had direct impacts on the country's startups and other ecosystem role players: namely the relaxation of exchange controls for loop structures and the scrapping of Section 12J of the Income Tax Act.

Lotz explains that the former impacts the ability of startups to raise capital offshore.

“Prior to the South African Reserve Bank issuing a circular at the beginning of the year, there was a prohibition on creating loop structures. Now, when a startup wants to raise capital offshore, South African founders, as well as the current South African investors, can swap their shares out into the foreign holding company so that everybody owns shares in the same entity. While the dispensation allows for loop structures, it only does so under particular circumstances and with certain caveats. The dispensation also doesn’t allow startups to do this without having to jump through regulatory hoops and request permission from the South African Reserve Bank with the help of lawyers.”

“Additionally, the loop structure needs to be cash settled. Unfortunately, most founders have their cash wrapped up in their businesses, so they don't really have this on hand to be able to then pay for shares in the holding company. What’s more, while the amount they have to pay out for their shares depends on the amount of investment they receive, they could have to cough up something in the region of R50 million. Plus, when this happens, a tax event is triggered,” adds van Lill.

In 2022, it is hoped that National Treasury and the South African Reserve Bank will consider these challenges and implement further exchange control relaxations. “We would also like to see Treasury provide rollover relief to startups which essentially is the deferral of capital gains tax until a later stage when the entrepreneur actually gets some cash in,” shares Lotz.

Section 12J

On the discontinuation of Section 12J, van Lill says that as this was a tax incentive to make investing in venture capital (VC) more attractive, this will make it more difficult for local VC fund managers to raise funds to invest in startups.

“However, one of the policy recommendations contained in the South African Startup Act framework which was made public earlier this year was for tax breaks and/ or tax incentives to allow for more investment into the VC industry. It cites Section 12J as an example, urging policymakers to take the lessons learnt from what didn't work, and to be narrower in the definition of the actual incentive while also re-introducing a version of Section 12J that will also benefit both National Treasury and the VC community.”

Modise shares that the recommendations on policy changes or government interventions covered by the Startup Act aim to eliminate the red tape obstructing the growth of startups. “However, they are not new. What we have been able to do is correlate them under one umbrella. If we want more innovation-driven startups to drive economic growth and job creation, we have to start working on them now.

Policy and regulatory issues

“In the new year, the South African Startup Act steering committee will be working on coalition building and making it easier for more people to get involved, to have a voice, to interact and to engage around matters that impact them. We will also be educating startups and the ecosystem about the policy and regulatory issues that they will encounter as they scale. Additionally, we will be having more interactions with stakeholders and members of the public.”

Lotz concludes by saying, “Even though policymakers seem to want to make a difference, and make the landscape easier for SMEs and startups, it often doesn't necessarily translate directly into what comes through in the legislature. What the Startup Act is trying to do is to highlight the factors that would make a very big difference. There are a number of policy issues which are holding startups back from being able to create jobs and economic growth. My hope, is that in 2022, we will see changes to policy that will create a more enabling environment for the country’s startups.”

For more about the South African Startup Act, go to <https://www.startupact.co.za/>