

Public Benefit Organisations: Policing the Tax Boundaries

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In 1999 the Commission of Enquiry into Certain Aspects of the Tax Structure of South Africa issued its ninth interim report dealing with fiscal issues affecting non-profit organisations. As a premise, it accepted as a broad consensus that NPOs are seen to be a relatively cost effective in delivering social and developmental services in a manner which relieves the financial burden which otherwise would fall upon the State. Further NPOs are seen to promote important values in society, including voluntarism, self-responsibility and participative democracy as well as operating in society such as South Africa where there exist gross disparities of income and wealth and where NPOs constitute an important mechanism for encouraging philanthropy and prompting greater equity and the implementation of a redistributive policy.

At the time the principle provisions of the Income Tax Act of 1962 which governed NPOs were Section 10 and Section 18 A. Section 10 dealt with exempt income; that is the income of religious, charitable and educational institutions of a public character and any fund, the sole object of which was to provide funds to any religious, charitable or education institution contemplated in the same subsection.

Section 18 A restricted the benefits of donor deductibility to universities, colleges and educational funds as defined and placed a cap on a deduction from taxable income not exceeding in the case of individuals of R 500 or 2% of taxable income and in the case of companies 5% of taxable income.

The Commission cited a series of examples to illustrate the restrictive nature of the dispensation. One example should suffice. A Section 21 company (that is a company not for profit) was refused tax exemption, notwithstanding that its main purpose was to “alleviate poverty and promote enterprise development in marginalised sections of South Africa, by developing and marketing educational and training materials and services as an institution of a public character.” The specific focus of the organisation was to develop innovative training materials and computer based methodologies to advance entrepreneurship, a strategy targeting conditions of poverty

and unemployment. Its record showed that it enabled more than 7,000 previously unemployed persons to start their own businesses.

In submitting its application to Revenue, attention was drawn to the statement of the Minister of Finance in his 1998 Budget to the effect that government itself had responded to the key objective of the Presidential job summit to convert the challenge of unemployment into an opportunity of job creation.

In refusing the application the Commissioner's advice read thus:

'Section 10(1)(f) of the Income Tax Act provides for an exemption in respect of the receipts and accruals of religious, educational, and charitable institutions of a public character.

The Courts have, in the past, held that an educational institution of a public character, as contemplated in Section 10(1)(f) of the Act, is regarded as a formal institution of learning where a formal course of study, instruction or training is imparted.

In a recent appeal case heard overseas, the High Court held that the word "education" connotes the process of training and development of the knowledge, skill, mind and character of students by normal schooling. It is not used in the wide sense according to which every acquisition of further knowledge constitutes education.

Furthermore, it must be noted that the Income Tax Act does not define "charitable". Under common law it has an extensive meaning. It has, however, been held that the fact that the Legislature has specified each category separately in Section 10(1)(f), "charitable" is to be used in a narrower sense. This has also been confirmed in the judgment delivered in 56 SATC 18 (on page 25).

In approving an exemption from income tax in terms of Section 10(1)(f) of the Income Tax Act, this Department has always interpreted "charitable" in the strict and narrow sense of relief of the needs of the poor.

The nature of the objects and activities of the company has been considered in the light of the aforementioned criteria and I am unable to agree that the company can be regarded as either a charitable or educational institution of a public character, as envisaged by Section 10(1)(f) of the Income Tax Act.'

Unsurprisingly the Commission recommended a complete change in the drafting policy so as to eradicate vast sweeping discretions which were given to the Commissioner and the formulation of legislation which provided clear objective criteria which can be uniformly applied by reference to jurisdictional facts, thereby removing concerns of subjectivity inconsistency and perceived discrimination.

Further, the Commission addressed Revenue's concern with regard to trading

activities as well as the contrary argument that the constraints in trading activities were unduly restrictive and tendered to discourage NPOs from being financially independent.

In general the Commission's recommendations were that the law should provide for a simple generic definition of tax exempt organisations which might be characterised as "exempt public benefit organisations," that the subjectivity of the present system should be replaced by objective criteria and that the defining characteristics of "exempt public benefit organisations" should include a public benefit purpose or activity falling within a schedule of activities or involving a further category described by Ministerial notice in the Government Gazette.

Further recommendations were the following: A formal registration in terms of the Non Profit Organisations Act which had been passed to ensure some discipline in the sector a formal written constitution, a minimum number of members, the application of the major portion of gross receipts for philanthropic purposes, a prohibition on the payment of remuneration to employees in excessive levels (that is which the Commissioner would consider to be excessive) an obligation to expend in any particular year at least 75% of net revenue accrued in the previous tax year save where otherwise approved by the Commissioner.

It also recommended a schedule listing eligible public benefit activities. Similarly it recommended that Section 18 A (the deduction section) which was unduly restrictive be enlarged by reference to a scheduled range of organisations and categories of activities which could qualify for a tax benefit (i.e. by way of a deduction).

Turning to trading activities it recommended the following:

'It is the Commission's view that the present constraints on trading activities are unduly restrictive and tend to discourage NPOs from becoming financially independent. Accordingly, it is proposed that trading by NPOs should henceforth be permitted, albeit within a carefully structured fiscal regime which facilitates oversight by the Commissioner and limits the opportunity for abuse.

The distinction between "related" and "unrelated" trading does, in fact, find some precedent in our own law. To the extent that trading forms part of the core activities of an NPO and provided that the promotion of the organisation's objectives rather than the pursuit of profit is the primary aim of the activity, it is deemed a "related activity".'

The Legislative Response

Government responded with reasonable favour towards these recommendations as a result of which a new dispensation was introduced, to which I now must turn.

The Present Dispensation

The receipts on accruals accruing from any public benefit activity of any approved public benefit organisation are exempt from normal income tax.

Public benefit activities are listed in part 1 of the Ninth Schedule to the Act or are determined by the Minister of Finance and published in the Gazette. For the purposes of this paper, the following categories are of particular importance:

- **Welfare and Humanitarian.** The provision of services to homeless children, elderly people, abused persons or people in distress, and the development of poor and needy communities.
- **Health care.** The provisions of health care services to the poor and needy persons, education on family planning and services in connection with HIV/Aids.
- **Land and Housing.** The development of stands and housing units for low income groups, residential care for certain elderly people and the building of certain buildings used by the community.
- **Education and Development.** The provision of education on all levels and training to the unemployed, disabled persons or government officials.
- **Religion, belief or philosophy.** The promotion or practice of a belief or philosophical activities or any religion that involves acts of worship, witness, teaching and community service.
- **Cultural.** The promotion and protection of the arts, cultures, customs, libraries and buildings of historical and cultural interest. The development of youth leadership is included under this category.
- **Conservation, environment and animal welfare.** The protection of the environment and the care and rehabilitation of animals, as well as environmental awareness programmes and clean-up projects.
- **Research and consumer rights.** Research in certain fields and protection of

consumer rights and improvement of products or services.

- **Sport.** The managing of amateur sport or recreation.
- **Providing of funds, assets or other resources.** If assets, resources or money are donated or sold at costs to a public benefit organisation, government department or person conducting one or more public benefit activities.
- **General.** Supporting or promoting public benefit organisations, as well as the bid to host or the hosting of any international event where foreign countries will participate and that will have an economic impact on the country.

A public benefit organisation is defined as any organisation:

that is a non-profit company as defined in the Company's Act or a trust, or an association of persons that has been incorporated, formed or established in South Africa or a South African agency or branch of a non-resident company, association or a trust that is exempt from tax in its country of residence.

The sole or principle objective of the organisation must be the carrying on of one or more public benefit activities as defined. These activities must be carried on, in a non-profit manner and with an altruistic or philanthropic intent. Their activities may not be intended to directly or indirectly promote the self-interest of any fiduciary or employee of the organisation, other than by way of reasonable remuneration. The activities of the organisation must be carried on for the benefit of or must be widely accessible to the general public at large, including the specific sector.

Donations to public benefit organisations and other qualified beneficiaries remain governed by Section 18 A. This permits the deduction of bona fide donations in cash or property in kind made by the taxpayer during the year of assessment. The beneficiaries to whom a donation may be made are public benefit organisations approved by the Commissioner that carries on certain activities to which reference will be shortly made, an institution, body or board that carries on certain activities together with any specialised agency as set out in schedule 4 to the Diplomatic Immunity and Privileges Act of 2001 on certain activities and information furnished to Revenue with a written undertaking that the agency will comply with Section 18 A requirements.

In particular, the activities which are critically relevant are:

- public benefit activities contemplated in Part II of the Ninth Schedule under the headings

- welfare and humanitarian
- health care
- education and development
- conservation, environment and animal welfare
- land and housing, or
- any other activity determined by the Minister of Finance by notice of the Gazette

An approved institution, board or body established under Section 10(1) (cA)(i) is

- one established by law
- that in the furtherance of its sole or principle object
 - conducts scientific, technical or industrial research, or
 - provides necessary or useful commodities, amenities or services to the State or members of the general public, or
 - carries on activities (including financial assistance) to promote commerce, industry or agriculture.

Donations may also be made to a PBO (a conduit PBO) approved by the Commissioner under Section 30 which provides for funds or assets to a PBO, institution, board or body contemplated.

The extent of the deduction can be summarised thus: A deduction is limited to 10% of the taxable income of the taxpayer as calculated before allowing any deduction under the Section 18 A provision.

Insofar as donations in kind are concerned, if a deduction is claimed by a taxpayer in respect of a donation of property in kind other than immovable property, the amount is generally determined as being the lower of fair market value or the costs to the taxpayer of the property concerned.

The section also provides that the recipient of the donation may issue a receipt (important for tax deduction purposes) that a donation had been made only if:

- the recipient is a conduit PBO
 - if it distributes or undertake to distribute at least 75% of all funds donated to it (this requirement has been lowered to 50% for

- donations made from 1 March 2015) during that year (the Commissioner may waive, defer or reduce this obligation) within 12 months after the end of the year of assessment to another qualifying PBO (the recipient PBO) (Section 18A (2A) (b)), and the receipt is issued to the extent that the donation received is used solely for the prescribed activities (Section 18A (2A)) of the recipient PBO (the recipient of the donation must also obtain and retain an annual audit certificate confirming that the donations were used for the prescribed purposes (Section 18A (2B) and (2C)).
- the recipient is any other PBO and the receipt is issued to the extent that the donation received is used solely for the prescribed activities (Section 18A (2A)) of the recipient of the donation (the recipient of the donation must also obtain and retain an annual audit certificate confirming that the donations were used for the prescribed purposes (Section 18A (2B) and (2C))).

Limitations in the Present System

A number of limitations have been raised, in particular by the non-profit sector with regard to the present dispensation. These can be summarised thus:

1. The establishment of non-profit organisations has been unduly complicated by a bifurcation of functions between the bodies with which new NPOs are required to register or interact before they are in a position to commence their operations. For example, a PBO is formed by its registration with the Companies Commission (a company) or the Master of the High Court (in the case of a trust). It must then submit a further application to the tax exempt unit of SARS and to the Non-profit Organisation Directorate.
2. Although the Ninth Schedule attempted to devise a comprehensive list of public benefit activities, the list remains fraught with a number of obscurities and anomalies both by way of inclusion or an omission and in particular the bifurcation of the Schedule in two parts,
 - a. Being comprehensive in nature; and part two being restrictive in identifying activities which are those eligible for a Section 18 A tax

- deduction is an unsatisfactory measure.
- b. The 75% distribution rule has proved problematic and the question arises as to whether a cap on the total value of the capital of the organisation would be a preferable system.
 - c. Regarding the 10% ceding on tax deductible donations, the question has arisen as to the taxpayer who elects to donate a higher percentage or even the total amount of taxable income to a PBO for public benefit purposes. Why is a cap being required?
 - d. Section 18 A does not deal sensibly with non-cash donations and the valuation thereof; for example if an artist donates a painting the value of a donation may well be no more than the costs thereof which could be negligible.
 - e. There are still considerable difficulties with regard to the limitation of trading by PBO's in the attempt to deal with the Revenue anxiety of a level playing field between NPOs and the commercial sector.

Conclusion

The restrictions and limitations of the present regime are under further review by the Davis Tax Committee which was set up by the Minister of Finance in August 2013 to examine all aspects of South African tax system. One of the major limitations which bedevilled the earlier enquiry in 1999 as well as the present investigation is the absence of rigorous evidence concerning the developmental success of the non-governmental sector. In turn this could inform an inquiry as to the appropriate demarcation of a sector entitled to a favourable tax dispensation.

At present the State, while not failing, is however not delivering a social wage in terms of its constitutional obligations. Institutions are all too often corrupt and unreliable. It is a notorious fact that South Africa is in the grip of major levels of corruption which go to the heart of the governmental enterprise. For example Transparency International Global Corruption Perception Index reveals that South Africa has dropped 34 places since 2001 with half the decline in places having occurring since 2009. South Africa is currently placed at 72 of 175 countries insofar as corruption is concerned. The Human Science Research Council Annual South African

Social Attitude Survey (2012) showed that the proportion of people who considered that corruption should be a national priority, almost doubled from 14% to 26% in the five year period between 2006 and 2011.

The seething level of discontent, not only with regard to corruption but coupled thereto, inadequate delivery by the State, is reflected in the nature of service delivery protest defined to refer to organised protest action within the local area which directly targets municipal government or targets municipal government as a proxy to express grievances against the State more widely.

In 2007, for example, there were 98 such protests whilst in 2014 there were 218. (DM Powell, M O Donovan and J De Visser Civil Protest Barometer 2007-2014).

These figures reveal the extent of the importance of developing a coherent argument as to the ability of the non-governmental sector to deliver significantly the area of social and economic development, where manifestly there is such significant dissatisfaction with the level of delivery produced by municipal, provincial and national government. In turn, this may justify a more expansive tax regime.

The imperative to have a vigorously independent non-profit sector in the light of these political considerations is also reflected in the source of income perceived by these organisations. In the latest statistics available, it appears that of the total income of South African non-profit organisation for the years 2010-2012, government subsidies are the highest source of income (39.8% and 39.2% for 2010-2012 respectively) followed by local donations (19.5% and 28.5% respectively). From 2010 to 2012, the smallest contributors to the total income of South African non-profit income was service income (3.5%, 8.8% and 12% respectively) and income from sales were 5.5% and 6.8% and 2.7% respectively (National Accounts: Statistics of the Non-Profit Sector for South Africa 2012 (discussion document February 2015)).

It is appropriate to conclude by reflecting on the widespread scope, nature and number of non-governmental institution in South Africa which reflected in the following table, which criticism of the present context notwithstanding reflects the breadth and resilience of the sector in South Africa.

Table 1: Types of non-profit institutions by legal entity and objectives, 2012, 2013 and 2014 (number)

Objectives	Types of NPI 2012			Types of NPI 2013			Types of NPI 2014		
	Voluntary associations	Non-profit companies	Non-profit trust	Voluntary associations	Non-profit companies	Non-profit trusts	Voluntary associations	Non-profit companies	Non-profit trusts
Culture and recreation	4,264	154	113	4,321	158	88	6,846	344	141
Education	5,636	319	311	6,472	344	342	8,545	497	372
Health	8,895	187	114	8,106	164	112	11,243	275	139
Social Services	33,742	331	217	33,386	351	235	49,095	1,038	289
Environment	899	65	74	936	70	78	1,307	104	94
Development and housing	16,005	617	284	17,998	644	294	24,565	1,310	425
Low, advocacy and politics	1,658	76	40	1,817	92	42	2,637	151	60
Philanthropic intermediaries and voluntarism promotion	366	84	518	391	89	528	541	124	592
International	55	5	3	52	5	2	69	7	5
Religion	9,494	276	156	9,640	295	154	14,517	508	190
Business and professional associations, unions	462	49	9	442	49	10	903	88	11
Total	81,476	2,163	1,839	83,471	2,261	1,885	120,268	4,446	2,318