REPORT ON

THE PUBLIC BENEFIT ORGANISATION AND THE TAX SYSTEM

FOR THE MINISTER OF FINANCE

Intended use of this document:

The Davis Tax Committee is advisory in nature and makes recommendations to the Minister of Finance. The Minister will take into account the report and recommendations and will make any appropriate announcements as part of the normal budget and legislative processes.

As with all tax policy proposals, these proposals will be subject to the normal consultative processes and Parliamentary oversight once announced by the Minister.

THE DAVIS TAX COMMITTEE

March 2018

Dear Minister

We, as the Members of the Davis Tax Committee, have the honour and privilege to provide you with this report which has been:

Prepared by:

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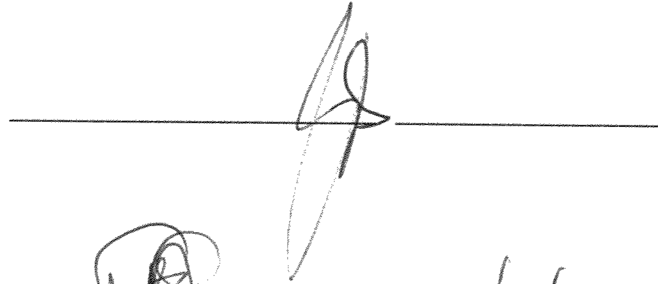

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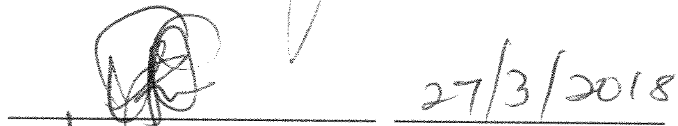

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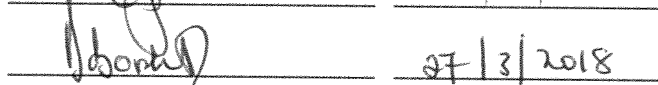

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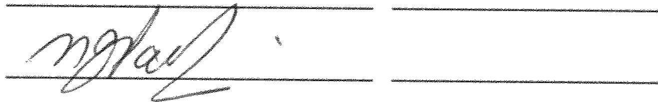

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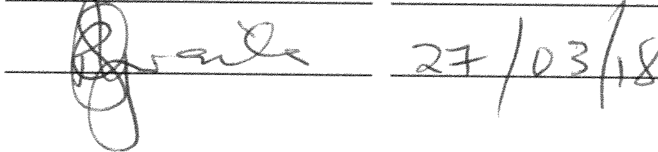

And the following ad hoc Members:

Richard Rosenthal (Attorney)

Ricardo Wyngard (non-profit lawyer)

Keith Engel (SAIT)

Mark Kingon (SARS)

Minee Hendricks (SARS)

Zalisile Ndzala (National Treasury)

And the Secretariat for the Davis Tax Committee

THE PUBLIC BENEFIT ORGANISATION AND THE TAX SYSTEM

Introduction

The scale of philanthropy in South Africa is significant; hence the need to examine whether the present tax dispensation remains appropriate to the needs of the country. Approximately 35 million South Africans over the age of 18 donate a total of R22 billion per annum (as each adult South African give approximately R 75 per month on average) to a wide range of recipients from faith based organisations, schools to charities and individuals. It would appear that the size of the high net worth South African market constitutes approximately 300 000 individuals, who have donated approximately R 8 billion in cash, R 5.1 billion in goods and services and 7.9 million hours of their time over the course of a year .[1] It has been estimated that the NPO sector can be valued at R60 billion[2].

A further study conducted of 21 of the largest charitable foundations in the country revealed that their collective 2015 'grant making spend' was R763,8 million and on average these foundations paid out of between 4-5% of their capital each year. Annual grant making spending ranged from R300 000 to R125 million and key focus areas included education, health, social justice, welfare, entrepreneurship, the arts and the environment.[3]

It has been argued that these organisations effectively ease the burden on the State with respect to the provisioning of key social and economic goods. The Katz Commission in its report on the NPO sector noted that:

> 'There is a broad consensus in the international community regarding the justification for such beneficial treatment. Factors which are most frequently cited include the following:
>
> (i) NPO's are seen to be a relatively cost-effective means of delivering social and development services in a manner which relieves that financial burden which otherwise falls upon the State;

[1] ICE Report "Review of philanthropy within South Africa" 26 April 2016
[2] Business Day 9 February 2017
[3] Sheilagh Gastrow and Amanda Bloch: Form and Function: A view of the financial and operational practices of South African private philanthropic foundations (2016)

(ii) as civil society initiatives, NPO's are seen to promise important values in society, including voluntarism, self-responsibility, and participative democracy; and

(iii) in societies such as South Africa where there exist gross disparities of income and wealth, NPO's represent an important mechanism for encouraging philanthropy and promoting greater equity and redistributive policies.

These are further justifications that may be offered:

1. Tax-exempt status may be justified because the activities of the non-profit sector are direct replacements for governmental obligations. The notion is that government should not tax organisations, thus reducing their ability to deliver goods and services by the amount of the tax, when that reduction merely creates a vacuum which must be filled by the government itself.
2. Tax exemption may be justified because of the way non-profit organisations contribute to pluralism. The notion is that such organisations provide goods and services for the public, but perhaps more efficiently and in any event with more diversity than the government. As Belknap puts it:

   '[G]overnment has granted the charitable tax exemptions in order to encourage voluntary private organisations to carry out certain activities which by common understanding are agreed to rate among the highest in the scale of social values. The preference that these activities be carried out by voluntary private organisations is based upon two advantages that private action in these fields enjoys over government action.

   "The first advantage is that voluntary private enterprise can often do the job better.

   …

   The second advantage of private control … lies in the effect of such control upon the overall pattern of our society. … [T]he broad

ramifications of freedom require a preference for private activity and diversity."[4]

3. Tax exemption may be explained by the inappropriateness of applying customary measures of "income" to not-for-profit entities.
4. Tax exemption may be justified on the grounds that taxing the not-for-profit indirectly would impose the tax burden on its customers and beneficiaries, but without taking into account their ability to pay.

In a more recent article Boshoff and Engelbrecht (2016 Tydskrif vir Geesteswetenskappe 583) conclude a study of this section by contending that due to the challenge of service delivery, the State should rather view the service organisations as resources in the restructuring of the South African social delivery system than considering the redirection of financing from essential services by established public benefit organisations (PBO's) in the informal sector.

This report is concerned with the relationship between tax and philanthropy in South Africa and, in particular, whether the encouragement and the enablement of philanthropic giving which may be an important aspect of domestic resource mobilisation for the provisioning of social and economic goods can be enhanced by amendments to the overall tax environment relating to philanthropy.

Submissions

The DTC's PBO subcommittee was set up to canvass a wide range of views. It received a series of submissions relating both to the implications of sections 10(1)(cN) and 30 of the Income Tax Act, 1962 as amended (the Act) which deals with the exemption of income tax to be paid on income received by or accrued to a PBO and section 18A which concerns the deductibility of contributions made to PBO's.

In the submissions received, the following were the key issues raised:

(i) The bifurcation or splitting of functions between SARS and the Department of Social Development's Directorate for Non-profit Organisations;

[4] Belknap, The Federal Income Tax Exemption of Charitable Organisations: Its history and underlying policy (1954) at 2035-2036

(ii) the need to distribute an unreasonably large amount of the funds received in the particular tax year by the end of the succeeding tax year;

(iii) the ceiling imposed by section 18A of the Act on the quantum of the donations (10%) which may be recognised as tax deductible in a particular year;

(iv) The definition of public benefit activities as contained in the Ninth Schedule to the Act.

In its response, National Treasury adopted the position that the tax system alone cannot encourage greater levels of philanthropic spending. In 2014 several amendments to the Act were made to make the overall tax environment relating to philanthropy more accommodating, including lowering the distribution requirement for PBO's from 75% to 50%. Further, Treasury argues that South Africa has a very transparent and open tax policy process which does not require major change, albeit it accepts that certain regulatory issues can be improved.

The present position

The following table provides guidance to the activities of organisations which may be exempt from tax and activities to which a contribution will be tax deductible.

Public Benefit Activities(PBA's)	
Exemption	Plus Deduction
➢ Welfare and humanitarian	➢ Welfare and humanitarian
➢ Health care	➢ Health care
➢ Land housing	➢ Land and housing
➢ Education and development	➢ Education and development, including private schools (in terms of donations, not school fees)
➢ Religion, Belief or Philosophy	➢ Conservation, Environmental and Animal Welfare
➢ Cultural	
➢ Conservation, Environment and Animal Welfare	
➢ Research and Consumer Rights	
➢ Sports'	
➢ Provisions of funds, assets or other resources	
➢ General	

Furthermore limits are posed in terms of section 10(1)(c)(N) in respect of income from trading which is exempt from tax. Permissible income falls into five categories:

Limits Against Trading

- Passive income (e.g. receipt of interest, dividends, capital gains)
- Business/trading if:
  - Integral and directly related to the PBO's sole/principal object
  - The substantial whole of the conduct is directed toward cost recovery (85%)[5]
  - The activity does not result in unfair competition against taxable business
- Business/trading if occasional and with substantial reliance on volunteers
- Business/trading with Ministries approval (never used)
- Any business/trading not greater than 5% of total receipts or R 200 000[6]

Evaluation of the key submissions

This report seeks to interrogate these particular questions. A number of comprehensive submissions were made to the DTC which can be summarised thus:

1. The establishment of non-profit organisations has been unduly complicated by the bifurcation of functions between the bodies with which new NPO'SNPO's are required to register and interact before they are in a position to commence their operations as PBO's system. In particular, a PBO, if it is formed as a trust would have to be registered at the relevant Master of the High Court's Office and in the case of a non-profit company with the Company and Intellectual Property Commission before the directors can assume office and commence operations. Once registration has been achieved prescribed applications must be submitted to the tax exempt unit of SARS and to the Directorate for Non-Profit Organisations respectively, should the organisation wish to apply accordingly.
2. Although the Ninth Schedule to the Act represents a 'heroic' attempt to devise a comprehensive list of PBA's, the list remains fraught with a number of obscurities and anomalies both by way of inclusion and omission. In a

[5] See Binding General Ruling (Income Tax) No. 20 (Issue 2) dated 20 January 2016 "Interpretation of the Term 'Substantially the Whole'". In the strict sense the term "substantially the whole" is regarded by SARS to mean 90% or more. SARS will however, accept a percentage of not less than 85%.

[6] A PBO carrying on business undertakings or trading activities that do not fall within the above permissible exemptions will, subject to the basic exemption, be taxed on the receipts and accruals derived from all such other business or trading income. The greater of 5% or the total receipts and accruals of the PBO or R 200 000 will be deducted from those receipts and accruals.

submission received, it has been noted that a specific category of activities which has not been included in Part II of the Schedule are those listed under the heading "Cultural" which include youth leadership or development programmes. Youth development and youth intervention programs have been highlighted as a government priority – it is widely acknowledged that the growing number of unemployed youth poses a significant risk to economic growth, safety and peace in South Africa, and that work with youth should be supported; yet the exclusion of this category from Part II, it is argued, undermines the ability to raise funds for this important work.

3. A further submission was made regarding Part II (2b) of the Ninth Schedule:

   '*The care or counselling of terminally ill persons or persons with a severe physical or mental disability, and the counselling of their families in this regard.*'

   There are many PBO's that provide valuable support services to persons with severe physical and mental disabilities. These include sheltered employment, sheltered accommodation and upliftment programmes leading to their access to and meaningful participation in the economy and society as a whole. These programmes not only improve their physical and emotional development, but also relieve the burden on their families and state resources. Accordingly it has been submitted that these should be added as another PBA under Part II, 1. Welfare and Humanitarian:

   'These provisions of support services, including sheltered accommodation and employment, to persons with severe physical and mental disabilities.'

4. In particular, the bifurcation of the Ninth Schedule into two parts, Part I being comprehensive in nature and Part II, being restricted and identifying those activities which are eligible for s 18A tax deductibility is an unsatisfactory measure. Accordingly it is proposed that tax deductibility under s 18A should be granted provided that the envisaged activity falls within the parameters of the Schedule.
5. The provision of support services and 'the promotion of the common interest of other public benefit organisations' are not eligible for a s 18A tax deduction,

despite the fact that PBO's benefit from their support and may be involved in activities listed on Part II of the Ninth Schedule.

6. In terms of section 18(2A), (b)(i), a PBO which provides funds or assets to an approved PBO was required to distribute at least 50% of the funds received in a particular tax year by the end of the succeeding tax year The 50% should consist of funds received by the funding organisation which represent a tax-deductible donation. In addition, the organisation is required to distribute all amounts received in respect of investment assets held by it in terms of the requirements set out in s 18A(2D) of the Act.
7. As a result, donors who are seeking to commit to sustainable, longer term philanthropy through the setting up of a funding foundation/organisation are dis-incentivised to do so. This rule hampers the build-up of an endowment within such a foundation. In addition, the administrative requirements to ensure compliance with this section are onerous, and non-compliance as a result of lack of awareness and understanding is likely.
8. It has been submitted that this restriction should be relaxed, and the distribution requirement reduced to 25% of funds received, to facilitate a tax environment within which the longer-term capital funding of endowments within foundations that provides funds to other PBO's and qualifying entities, can more easily take place. In justification of this amendment is the argument that it will enhance the sustainability of funding organisations and donor foundations. In difficult economic times, foundations with sustainable endowments can continue to fund organisations regardless of the availability of further donations into the foundations, whereas those acting as mere conduits are able to do this.
9. At the very least, the requirement to distribute amounts received in respect of investment assets should be deleted as compliance therewith will prove to be extremely complicated and difficult.to implement.
10. The Private Philanthropy Circle (PPC) proposes that an alternative to this requirement be found, One of which alternatives would be to ensure the distribution by such organisations in pursuance of its activities of not less than 4% of the total value of capital of the organisation. Another proposal by the Non-profit and Donor Organisation Professional's Forum (NPDOF) was that the distribution requirement be reduced to 25% of the funds received. It has

been suggested by the NPDPF that this requirement should be deleted and if a requirement is needed it could be that 5% of total funds be distributed annually unless special reasons can justify an exemption.

11. A concern was expressed regarding the 10% ceiling on tax deductible donations. It was contended that if a taxpayer elects to donate a higher percentage or even the total amount of his or her taxable income to an approved PBO for public benefit purposes, there is no reason for placing such limitation upon such a taxpayer.
12. Section 30(3)(b) of the Act contains a requirement that the founding document of a PBO must contain various prescribed conditions set out in the legislation. Initially it was required that pre-existing organisations should bring about the necessary amendment within a period of five years of the coming into force of the legislation. A significant number of organisations have omitted to do so within the prescribed period. Section 30(4) was subsequently enacted to stipulate that the filing of a written undertaking of compliance may suffice. Therefore it is not necessary for the founding document to repeat the applicable conditions.
13. It has been submitted that the way that the section 30(3)(b)(iv) is phrased gives rise to some confusion, as the word 'submit' implies more than just the after-the-fact notification that is now required, and we often find that organisations believe that they require the prior approval of the SARS Tax Exemption Unit (TEU) for any alterations to their founding documents.
14. Thus it is suggested that section 30(3)(b)(iv) of the Act be amended to read:

    '*required to provide the Commissioner with a copy of any amendment to the constitution, will or other written instrument under which it was established*;'

15. Trustees, office bearers or directors and new appointees may not consider themselves bound by the written undertaking which was signed by the persons accepting fiduciary responsibility for the PBO at the time the application for approval as a PBO was submitted to the Commissioner. The best way to bind a PBO is to require the conditions and requirements of section 30(3)(b) of the Act, to be incorporated into the founding document. It is argued that there is an inconsistency between subsections (3) and (4). Section 30(3)(b)(i) provides that no single person may directly or indirectly

control the decision making powers of an approved PBO. It is contended that it should suffice that persons serving on the board of a PBO should act at all times in a bona fide manner in the best interests of the intended beneficiaries and without advancing self-interest.

16. It is suggested that legislation be considered to make explicit a provision for the disclosure of relevant information by all approved PBO's that seek and enjoy a tax exempt status.
17. Section 18A of the Act does not deal adequately with non-cash donations and the valuation thereof. For example, if an artist donates a painting, the value of the donation may well be no more than the cost thereof which could be negligible, notwithstanding the significant value of the painting.
18. Objection is taken to the restriction that a maximum rental on 10% of the letting space let by PBO to a third party can be exempt from tax but the balance will be subjected to tax. It is contended that this treatment is anomalous and prejudicial to PBO's, preventing them from the holding of property for rental purposes which may represent a prudent investment.
19. Although section 30 of the Act makes provision for approval as a PBO to be granted with retrospective effect, there is no similar provision with respect to section 18A.
20. Regarding non-South African activities, section 30 of the Act has been amended to permit PBO's which are established in South Africa to conduct PBA's in other parts of Africa without restriction. Section 18A of the Act has not been similarly amended. The justification is to be found in a Tax Court decision in ITC 1872; 2014 (76) SATC 225 where the Court held that authority to issue a tax deductible receipt under s18A of the Act has an effect of reducing the tax base in the Republic. The donors of such donations are issued with tax deductible receipts on the basis of which they can claim a tax deduction based on such donations and therefore reduce a tax base in the Republic. Hence only donations used to carry on PBAs in the Republic should qualify under section 18A of the Act.
21. The issue of support for micro enterprises and the encouragement of self-employment initiatives do not fall within the Ninth Schedule to the Act, save to limit grants or loans to no more than R2 500. The Ninth Schedule to the Act also includes a far too narrowly defined PBA, described as 'the provision of

training for unemployed persons with the purpose of enabling them to obtain employment.” It is argued that this provision does not adequately address the importance of supporting and encouraging (on a non-profit basis) the formation of SME’s.

22. Although there has been some acceptance in principle of a PBO supplementing its resources by means of income generation with the view to self-sustainability, the matter is still replete with confusion; hence the need for clarification of the ‘trading’ requirement.
23. This comprehensive set of recommendations was met with a detailed memorandum prepared by SARS, which requires equal attention.

The SARS Response:

Regarding trading, SARS points out that a trading activity and business undertaking will only qualify for exemption if the trading activity meets all three requirements namely;

1. It is integral and directly related to the sole or principal object of carrying an approved PBO.
2. Is carried out or conducted on a basis substantially the whole of which is directed to the recovery of cost; and does not result in unfair competition in relation to other taxable entities.
3. Very often organisations fail to comply with all three aspects.

24. Regarding extensions to s18A, SARS contends that receipts can only be issued for bona fide donations. A number of donations do not fall within this particular category and SARS has to take account of them; these being:
    - Tithes and offerings
    - Donations of a service such as time, skill or effort to an approved organisation
    - Amount paid for attending a fundraising dinner, dance or charity golf day.
    - Amount paid for the successful bid of goods auctioned to raise funds by an organisation and goods donated to be auctioned to raise funds
    - Sponsorship and advertising
    - School fees, entrance fees for school admittance or compulsory school levies.

25. Referring to the arguments set out in respect of section 30(3)(b) of the Act, SARS argues that founding documents are often not amended within the requisite 12 month period to include provisions of section 30 of the Act. Before section 30(4) of the Act was amended in 2014, the written undertaking was an interim measure to enable an organisation to obtain approval as a PBO under section 30(3) of the Act despite its founding document not complying with the prescribed requirements of section 30(3)(b) of the Act. Although an organisation may have submitted the required written undertaking and been granted PBO approval, it was practice that the relevant requirements of section 30(3)(b) of the Act was still incorporated in its founding document.
26. Generally SARS requires the PBO to amend its founding document within a reasonable period, which was considered to be 12 months from the date of the letter issued by SARS confirming the PBO approval, or on the date on which any other amendment were effected to the founding document, whichever came first.
27. SARS is not notified of changes to office bearers, founding documents, addresses, etc. Proper records are not kept in particular relating to inspection for a period of five years and there is often a failure to inform SARS if the PBO is no longer carrying on approved PBA’s.
28. SARS has a great concern regarding commercialisation of fundraising. Organisations provide commercial services to PBO’s do not provide support services as anticipated in the legislation and this is an increasing mischief. Similarly, the provision of marketing, advertising and fundraising services are not PBA’s and do not represent part of a *bona fide* donation made by donors and should be excluded upfront.
29. There is a legitimate question raised with regard to governance, in particular with respect to incorrect values in section 18A receipts or receipts issued for incorrect donations. Furthermore SARS contends that greater transparency is needed in respect of administration and personal costs, type of commercial agreements entered into for fundraising initiatives, flat rate commission structures paid for fundraising, trademarks, etc.

The National Treasury response

National Treasury has also offered its response to the various proposals put forward to this committee.

1. Administrative requirements regarding registration.

   Treasury notes that the 2006 PBO's were required to register with a directive as a nonprofitable organisation (NPO), as a precondition for exempt status in terms of the Income Tax Act, 1962 granted by SARS. PBO's may have been exempt from the dual registration requirement only if both the directorate of NPO's and SARS approved. However in in terms of a Revenue Laws Amendment Act, 2006, the dual registration requirement was removed. Accordingly SARS grants exemption to PBO's without the NPO registration as a precondition. Thus, the NPO Act's registration requirements for the PBO's are voluntary not mandatory.

   Treasury however supports the notion that the Department of Social Development should provide clear indications on the system of "supposed administrative voluntary registration flaws raised by the PPC.

2. The splitting of the Ninth Schedule

   Part I of the Ninth Schedule to the Act deals with the activities determined by the Minister of Finance which are eligible for exemption in terms of section 10(1)(cN), that is certain receipts and accruals of a PBO approved by the Commissioner under section 30(3) of the Act are exempt from normal tax under section 10(1)(cN) of the Act. Part II deals with activities that qualify for tax deductible donations in terms of section 18A of the Act. Treasury notes that there are few activities listed in Part II as compared to Part I. Whilst not opposing a review Treasury contends that this must be subject to thorough quantifiable evaluation of the possible costs to the fiscus.

3. Distribution rules

   Distribution rules consider that the change distribution rule to 50% should remain.

4. Donations tax deduction

   A change was made with effect from 1 March 2014 to remove the inflexible cut off at the 10% limitation. Consequently donations in excess of 10% are no longer fully lost as a deduction excess of this amount can be claimed as a deduction in subsequent years of assessment (subject to the 10% rule).

5. Treasury contends that the South African tax regime is comparable to countries of similar levels of development as is evident from the following table.

According to Treasury South Africa is on par with other countries in terms of its justification on tax benefits granted to PBO's. In support thereof Treasury set out the following table which reflects the tax dispensation in merging modern tax systems throughout the world.

COUNTRY	CHARITY EXEMPT FOR TAX PURPOSES (YES/NO	BASIS FOR EXEMPTION	DONOR'S TAX LIMITATION	ABUSE CONCERNING CHARITIES/ ADDITIONAL INFORMATION
Argentina	Yes	A charity is a legal entity exempt from paying tax on revenue arising from its charitable activity.	**Corporation and Individuals**: Deduction is limited to the maximum of 5% of the company's net taxable income.	They believe that there have been cases of tax evasion.
Chile	Yes	NPO's can request an exemption from income and investment taxes so long as their goal is to provide financial assistance. Properties owned and used by charitable organisations are exempt from the real estate tax.	**Corporations:** the deductible amount may not exceed 5% of the company's net taxable income. **Individuals:** Presently, it appears that there are no tax benefits available for individual donors in Chile	Charities have to report to the tax authorities, the donations received and the identity or the donors.
Czech Republic	Yes	A foundation can operate only as a charity for public benefit purpose, not for private benefit of its founders. A foundation is exempt from tax on its income.	**Corporations:** The minimum deductible donation is CZK 2,000 and the maximum deductible donation is 10% of the tax base. **Individual**s: Donations provided to certain organisations or individuals are deductible up to a maximum of 15% of the tax base, provided the total value of the donations exceeds 2% of the tax base or is at least CZK 1,000. Blood donation is also considered a form of charitable donation which is valued CZK 2,000 per one blood collection.	They have identified on an annual basis, approximately 3-5 suspicious transactions involving the non-profit sector. No specific statistics are available regarding tax evasion through charities nevertheless some cases of tax evasion have become famous through the Supreme Administrative Court decision.
Turkey	Yes	Charitable organisations, public and private foundation that are resident and established in Turkey have generally no tax liability.	**Corporations**: Donations to listed charities and for construction of schools, hospitals, and scientific research organisations are deductible at up to 5% of the company's gross profit. **Individuals**: Personal deductions are possible within defined limits for donations to specific institutions.	

6. <u>Prescriptive conditions</u>

   Treasury points out that the founding document is a mandatory requirement which must be submitted for approval as a PBO in order for the latter to be entitled to be granted exemption for tax purposes. In terms of section 30(3)(b) of the Act, a document must be in a form of a will, constitution agreement which must comply with the prescribed conditions laid out in section 30(3)(b) of the Act, including that it has been established in the following terms:

   (i) *It is required to have at least three persons, who are not connected persons in relation to each other, to accept the fiduciary responsibility of such organisation and no single person directly or indirectly controls the decision making powers relating to that organisation. Provided that the provisions of this subparagraph shall not apply in respect of any trust established in terms of a will of any person;*

   (ii) *It is prohibited from directly or indirectly distributing any of its funds to any person (otherwise than in the course of undertaking any public benefit activity) and is required* to utilise its funds solely for the object for which it has been established.

Treasury contends further that section 30(4) of the Act provides for flexibility where the founding document of the PBO does not so comply with the section 30(3)(b) requirements. In Treasury's view section 30(4) assists PBO's which are confronted with unamendable founding documents, as it provides as follows:

> '*Where the constitution, will or other written instrument does not comply with the provisions of subsection (3)(b), it shall be deemed to so comply if the persons contemplated in subsection (3)(b)(i) responsible in a fiduciary capacity for the funds and assets of a branch contemplated in paragraph (a)(ii) of the definition of "public benefit organisation" in subsection (1) or any trust established in terms of a will of any person furnishes the Commissioner with a written undertaking that such organisation will be administered in compliance with the provisions of this section.'*

7. <u>No single person control</u>

   Treasury responds to the suggestion that the stipulation that there be at least three persons who are not connected persons to accept fiduciary responsibility for the PBO has adverse implications for private or corporate

donors because typically board members are appointed by the company or the donor, which has provided the capital endowment.

Treasury is concerned to maintain the principle of independence between a donor and a donee. A donor should not have an impact, control or discretion over the donation. Accordingly, Treasury resists any possibility that representation and fiduciary responsibility be extended to donor representatives becoming trustees and thereby being able to police the manner in which the PBO utilises the donation.

8. Section 18A: non-cash donation

A general principle enshrined in section 18A of the Act is that the deductibility of non-cash donations or donations of property in kind must be valued at the lower of cost to the donor or fair market value of the asset on the date of the donation. Treasury is concerned about a possible risk to tax collection that may arise from 'in kind' donations which are valued strictly at market value and therefore suggests that there should be no revision in relation to this provision.

9. Investment and real-estate and income generation or trading

Paragraph *(b)*(i) of the definition of PBO which appears in section 30(1) of the Act requires PBA's carried on a PBO to be conducted in a non-profit manner and with an altruistic or philanthropic intent'. A trading activity will only qualify for exemption in terms of section 10(1)(cN) (ii)(aa) if that activity meets the following three requirements:

1. The undertaking of activities integral and directly related to the sole or principle object of the PBO;
2. Is carried out or conducted on a basis of substantially the whole of which is directed towards the recovery of costs; and
3. Does not result in unfair competition in relation to taxable entities.

Treasury contends that this regime is not at war with the objective of the PBO supplementing its income but rather its approach reflects a policy which attempts to create a balance in ensuring that PBO's are not advantaged unfairly when competing with commercial entities. Accordingly Treasury wishes to retain all three of the requirements as set out above.

10. Microenterprises BEE and entrepreneurship

Prior to 1 March 2015, funding or payments received by SMME's for their development were taxable unless received from Government in the form of "a government grant'' in terms of s 12P, of the Act. Treasury points that in order to assist this sector to better utilise gratuitous funding, amounts received by SMME's from approved funding, entities in terms of section 30C are exempt from normal tax. These SMME's will have to meet the requirements of a micro enterprise in terms of the Sixth Schedule to the Act or a small business corporation in terms of s 12E of the Act. Any expenditure incurred in respect of trading stock allowed as a deduction in terms s 11(a) or any amount taken into account in respect of the value of trading stock or the base cost of an allowance of an asset must be reduced to the extent that the amount received or accrued from the small business funding entity is applied for this purpose. Treasury suggests that as these changes were made with effect from 1 March 2015 and that they should remain.

Evaluation

We turn to an evaluation of these competing submissions. Comparing the key PPC submissions particularly with those of the Treasury, it appears that the following are the core disputed issues which require determination from this Committee:

1. The appropriate regulatory mechanism

   The International Consulting Expertise (ICE) report dealt briefly with taxation, as noted above, and concluded thus:

   "*The issue of taxation was raised with all the interviewees during the focus group and in-depth interview processes. Taxation per se was not deemed a significant or issue for almost all of the philanthropic foundations that we spoke to. While there were one or two issues raised, the pervading sense was that the tax system was not the problem. It was more specifically the administration of the system and, in particular, the registration around obtaining NPO status with DSD that was deemed to be problematic. A number of foundations pointed to the high level of effort and time spent in dealing with registration problems, deregistration threats and notification of deregistration.*"

The NPO sector has to comply with the dictates of multiple regulatory organisations including the non-profit organisation directorate SARS, the Master's Office and the Companies and Intellectual Property Commission.

One possible solution is to develop an institution along the lines of the UK Charities Commission or some other form of simplified but coherent regulatory mechanism. A variation on this theme would be for the Department of Social Development to ensure that all NPO's be regulated by itself of which a defined subset would be classified as PBO's (also require SARS approval). The NPO sector has grown significantly. The Department of Social Development database contains the following:

- NPO registration has increased substantially since the inception of the NPO Act. According to the NPO register (as at 05 February 2016), there were 150,456 NPO's registered NPO's.
- SARS has a total of 49 027 PBO's on register. The number of taxpayers on TEU register has increased by 6.72% compared to 45 728 at the beginning of the financial year (TEU Operational Report 2-16/2017).

There is thus a significant discrepancy between the number of NPO's on register with DSD compared to SARS' PBO register: 150 000 v 49 000.

The discrepancy between the two registers raises not only several compliance concerns for SARS, but also a broader systemic issue on why the non-profit sector is not complying with tax regulations. According to the DSD they are in the process of amending the NPO Act which will assist in promoting coherence

There is a clear misalignment or limited alignment within the regulatory system and between governing Acts across the different types of regulation. Legislation governing legal form, governance and taxation is not harmonised and congruent with each other. As a result, NPO's have to register multiple times with different regulators submitting the same information more than once.

The relevant government departments are mandated by law to regulate the NPO sector. This regulation can be categorized in two main phases namely at the point of applying and once approved, continued compliance.

There are also underlying or additional regulations that would apply for example with regards to the legal form of the non-profit entity and if the NPO functions in the service industry, regulations with regards to child services, services to the elderly etc.

Each regulator functions in its own sphere but does not look at the general burden of compliance it is creating on the sector as the whole. Manifestly this is an area that requires a specific and coherent response.

2. The Ninth Schedule to the Act

2.1 Introduction

The Ninth Schedule to the Act was introduced by the Taxation Laws Amendment Act, 2002, as a pivotal element of the newly-enacted PBO dispensation. Section 30 of the Act prescribes that approval of the PBO by SARS depends upon having as its sole or principal object one or more so-called "Public Benefit Activities (PBA's)". Accordingly the Ninth Schedule to the Act represents a comprehensive listing of all such activities as are currently recognised. Prior to the enactment of this legislation, it was left to the discretion of SARS to discern whether the activities of the non-profit organisation seeking tax exempt status fell within the three broad categories of eligibility for exemption – that is, whether they were "*charitable, educational or religious*". Inevitably this discretion gave rise to anomalies and inconsistencies; and in response to the recommendation of the Katz Commission, the legislature sought by means of the Ninth Schedule to the Act to provide certainly and circumscribe the scope for subjective discretion.

However, the Ninth Schedule to the Act served a further secondary purpose, in that it sought also to provide a separate listing of those preferred public benefit activities which would be entitled not only to tax exemption but also to the further fiscal benefit – involving the right of taxpaying donors to deduct from their pre-tax income the amount of donations made to eligible PBO's for purposes of one or more of the preferred list of public benefit activities contained in Part II of the Ninth Schedule to the Act.

Inevitably, any such ambitious attempt to identify and categorise all conceivable public benefit activities is bound to be incomplete and susceptible to error and omission. On no less than five occasions, thus far, these lists have been amended to address unintended omissions and anomalies. However, the lists remain manifestly imperfect, and the Committee has heard a number of representations, with regard to definitional problems, many of which were acknowledged by the representatives of SARS.

A fundamental question was therefore debated by the Committee as to whether in fact the present "bifurcation" of PBA's in Part II (General List) and Part II (Preferred List) was not arbitrary and unnecessary. Thus, it was contended that virtually all PBA's (with the possible exceptions of party politics and sport) should be treated equally by the fiscus, without attempting to impose some kind of hierarchy of value. It was pointed out that a great deal of time, cost and delay resulted from the need for the (TEU) to undertake this mandated segregation. The Davis Tax Committee (DTC) was sympathetic to the proposition that there should be a single composite listing of all PBA's; but concerned that in the present constrained economic circumstances, and in the absence of statistical information as to the probable costs to the fiscus of any such change, it was not in a position at this stage to support such a radical proposal.

Nonetheless, the DTC was persuaded that there were compelling reasons for certain specific activities to be elevated from the general list (Part I) to the preferred list (Part II). The rationale for this recommendation is the belief that these activities are of great importance and value to society; and that in relation to other activities which already enjoy the preferred status, they are certainly no less valuable or important to society than this which have already been so recognised.

Thus, for example, Youth Development Programmes, and promotion of the Arts, Culture and Customs are not preferred, whereas, Conservation and Animal Welfare are preferred. In consequence of this anomaly, the National Library; the National Gallery; the National Theatre, and all provincial and

regional theatres, concert halls, orchestras, ballet companies, et al, are excluded from Part 2 status, whereas some 15 495 organisation are given this fiscal preference, including such bodies as “Cats of Durban” and the “Grabouw Animal Welfare Society.”

2.2 Specific Proposals

In the circumstances, the Committee proposes that the undermentioned PBA’s which are currently listed only in Part 1 of the Ninth Schedule to the Act be included in Part II, viz:-

2.2.1 “***6. Cultural***

(a) The advancement, promotion or preservation of the arts, culture or customs.

(b) The promotion, establishment, protection, preservation or maintenance of areas, collections or buildings of historical or cultural interest, national monuments, national heritage sites, museums, including art galleries, archives and libraries.

(c) The provision of youth leadership or development programmes.”

2.2.2 “***11. General***

(a) The provision of support services to, or promotion of the common interests of public benefit organisation contemplated in section 30 or institutions, boards or bodies contemplated in section 10(1)(cA)(i), which conduct one or more public benefit activities contemplated in this part.”

[The latter item would then be repeated verbatim in both Part I and Part II. However, the phrase “this part” would refer in this context to Part 2 only.]

*2.2.3 “**10. Providing of Funds, Assets or Other Resources***

The provision of:-

(a) Funds, assets, services or other resources by way of donation;

(b) assets or other resources by way of sale for a consideration not exceeding the direct costs to the organisation providing the assets or resources;

(c) funds by way of loan at no charge; or

(d) assets by way of lease for an annual consideration not exceeding the direct cost to the organisation providing the asset divided by the total useful life of the asset, to any:

(i) public benefit organisation which has been approved in terms of section 30;

(ii) institution, board or body contemplated in s 10(1)(cA)(i), which conducts one or more public benefit activities in this part (other than this paragraph);

(iii) association of persons carrying on one or more public benefit activity contemplated in this part (other than this paragraph), in the Republic; or

(iv) department of state or administration in the national or provincial or local sphere of government of the Republic, contemplated in s 10(1)(a) or (b)."

[This item would then be repeated in both Part I and Part II. However, it would refer in this context to the provision of such funds, assets and other resources only for the conduct or support of activities listed in Part II.]

2.3 *Further Issues for consideration*

As indicated, the Ninth Schedule to the Act has evolved over a period of some 15 years and has been amended on several occasions since its original enactment. However, there remain (in addition to the specific matters referred to above where there was a clear agreement) a number of issues which in the view of the DTC warrant further consideration by reason of drafting anomalies and the omission of valuable activities from the listing of preferred "Public Benefit Activities". Accordingly, it is recommended that a review process be initiated with respect to the Ninth Schedule to the Act in its entirety, in order to consider problems or interpretation which have been experienced by the TEU, and in order to have regard to a number of specific issues which include the following:-

2.3.1 Although the Ninth Schedule to the Act includes reference to "*the promotion of human rights and democracy"* (Item 1(j)), there is no Item which covers the promoting and advancement of constitutionalism.

2.3.2 Although there are a number of generic Items which make reference to concepts such as "educational enrichment" and "addressing needs in education provision" (Items 4(m) and (n)), these Items only have reference to education within the context of formal institutions such as schools and universities, and there is no provision for public education – save for a narrowly defined item which provides for "*educational programmes with respect to financial services and products*" (Item 4(p)).

2.3.3 Although there is provision for "*legal services for poor and needy persons"* (Item 1(m)), there is no provision for legal services in the general public interest – such as matters affecting the environment, energy, transport, which do not exclusively involve *"poor and needy persons*".

2.3.4 For some obscure reason "research" (irrespective of the nature of that research) is deemed to be a Part I activity only, and is not eligible for Part II status. (Vide Item 8(a))

2.3.5 Although there is provision for financial assistance to be granted to "emerging micro-enterprises", this involves extremely small individual self-help initiatives, and is only recognised within the context of "*community development for poor and needy persons*". There is no general provision of the promotion or support of entrepreneurship in a broader context which is one of the priority goals of the National Development Plan.

(The granting of loans for emerging micro-enterprises is contemplated by Item 1(p)(iii)), subject to "*such conditions as may be prescribed by the Minister by way of Regulation*". This provision remains effectively inaccessible for the simple reason that the Minister has not prescribed the required Regulations. A similar problem arises with respect to the granting of loans for the construction of social housing or basic shelter, for the reason that the Minister has similarly failed to prescribe the conditions required by Item 3(f).

2.4 Conclusion

In the circumstances, the DTC recommends that a process be initiated in which there is an opportunity for public participation including an invitation to concerned non-profit organisations to raise issues and problems with respect to the Ninth Schedule to the Act.

In terms of s 30(1) of the Act, the Minister is afforded a right to include activities in addition to this listed in Part I of the Ninth Schedule on the basis that they are considered to be "*of a benevolent nature, having regard to the needs, interest and well-being of the general public*". Any such additional activity as may be determined by the Minister must be tabled in Parliament within a period of 12 months for incorporation into the Act. (See Section 30(2))

3. A *de minimis* rule

There are a number of entities that are required to register as PBO's with SARS in order to obtain tax exemption and enjoy the related benefits such as a donations tax exemption, however their operations are so small to comply with the requirements pertaining to both the registration and annual compliance requirements of SARS are rather onerous. These include small community based entities that are carrying on PBA's that are set out in the Ninth Schedule to the Act. Many of these entities are staffed by volunteers and are simply trying to do some good cause in a community.

There are a separate set of requirements where PBO's wish to issue tax deductible receipts in terms of section 18A of the Act.

Having regard to the administrative capabilities of small PBO's, consideration should be given to a number of options for smaller PBO's where there is a negligible tax risk:

3.1 Where an entity is funded primarily by public contributions which do not exceed, say R200 000 per annum (The minimum trading threshold in section 10(1)(cN)), where no tax deductible receipts are issued and no salaries are paid, a simple notification to SARS should suffice for registration, and a simplified declaration should be required annually to retain such status.

3.2 Where such entities wish to issue section 18A receipts, the following should be considered:

- That if they want to issue receipts in their own right, they will have to proceed with standard registration and reporting processes. This is due to the SARS risks attributed to 18A and the deduction allowed.
- That we allow a 18A “lite” registration for such entities if they are only in receipt of 18A funds from a 18A(1)(b) entity that has been approved.

4. The DTC’s PBO Sub-Committee received submissions concerning the capacity of the TEU. It has been claimed that delays are experienced by organisations making applications, most of whom cannot access donor funding until their application for approval under section 30 of the Act and for 18A status has been approved by the TEU.

It is important that the current experience of turnaround time is that an average of six months elapses between the lodging of the application and the date upon which approval is granted. Although the TEU aims for a 36 working-day turnaround time (which is just short of 2 months) the clock only starts ‘ticking’ once the compliance division has assessed the application and issued a tax reference number (for organisations not already registered for tax, which is most of them). This first part of the process takes about three months and then the file is sent to the analysts to be assessed for PBO/other exempt status to be granted. If there is a query at any stage, the clock is set to zero.

This delay has severe implications for donations as, although PBO status is back-dated to date of application or date of formation of the organisation, section 18A status is not back-dated, so 18A-dependent donations are lost to organisations. There also appears to be a backlog of ‘difficult’ cases which needs to be cleared.

In one submission made on behalf of a professional who works for / consults in the sector the following suggestions are offered.

4.1 Employ two more analysts to work on assessing cases for the awarding of PBO and other tax-exempt status;

4.2 Employ a dedicated clerk/PA for the analyst division, to ease the administrative burden on this part of the unit;

4.3 Enable the analysts to attend regional gatherings of NPO's. These encounters would boost their morale, and increase their understanding of the issues facing the sector, both of which would assist with the performance of their duties;

4.4 Increase the size of the email inbox capacity of the TEU, as inboxes are regularly full and incoming email is blocked; and

4.5 Increase the capacity of the unit to receive electronic documents via e-mail. Currently files with attachments over 1MB are blocked, which means that documents have to be mailed attached to several separate emails. The increase in use of secure password-access certified documents by banks, for instance, means that file attachment sizes are increasing, and so this capacity to receive files must be improved.

5. <u>Section 18 A</u>

Limitations have been pointed out with respect to s 18A in respect of conduit organisations where the PBO acts as a conduit to provide funding to a defined PBO. It has been suggested that the current section 18A dispensation constitutes a hindrance to these organisations, because of the 50% distribution rule and the further requirement in terms of s 18A(2D) that a PBO which provides funds or assets to another PBO must, no later than six months after every five years from the date of which the Commissioner has issued a reference number to it, distribute all amounts received in respect of investment assets held by it. The DTC recommends this provision be removed.