DLA CLIFFE DEKKER HOFMEYR

TAX

ALERT

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AN IMPORTANT JUDGMENT FOR PUBLIC BENEFIT ORGANISATIONS

Fiscal policy, as manifested in the Income Tax Act, No 58 of 1962 (Act), is that philanthropy should be encouraged. The Act achieves this objective by providing that, subject to certain criteria being met and subject to limitations, charitable organisations enjoy a very favourable tax regime and taxpayers who make donations to such organisations may deduct the donations for income tax purposes.

To qualify for the favourable dispensation, an organisation must be approved as a public benefit organisation (PBO) by the South African Revenue Service (SARS). The requirements for obtaining approval are set out in s30 of the Act. Put simply, to be a PBO, an organisation must carry on activities in a non-profit manner, its constitution must contain certain prescribed provisions and it must carry on one of the activities in the closed list of activities set out in Part I of the Ninth Schedule to the Act.

Once SARS has approved an organisation as a PBO, it is not liable for:

- income tax on its income (subject to limitations);
- capital gains tax;
- transfer duty when it acquires immovable property;
- dividends tax; or
- the skills development levy.

Once an organisation is approved as a PBO it usually wishes to go one step further to ensure that, to encourage donations to it, taxpayers who make donations to the organisation are able to deduct the value of donations for their income tax purposes. Most non-profit organisations no doubt rely on the philanthropy of outsiders to fund their activities.

Donations to PBOs are tax deductible if the requirements set out in s18A of the Act as read with Part II of the Ninth Schedule to the Act, are met.

The above principles were the subject of a judgment in the Western Cape Tax Court (unreported judgment delivered on 22 January 2014, case number 13254). In that case an inter vivos trust had applied for approval in terms of s30 and 18A of the Act. SARS decided not to grant the approval. The organisation objected to the decision and, when the objection was disallowed, the organisation appealed to the Tax Court.

The Court held that, on the facts of the case, the trust did meet the requirements of s30 of the Act and that it should have been approved as a PBO.

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However, the court found that the trust could not enjoy 's18A status', that is, persons who made donations to the trust were not entitled to deduct the donations for tax purposes. The reason why the court found in favour of SARS on that issue is that the trust did not intend to carry on all its activities in South Africa.

With respect, in my view, the finding of the court in relation to s18A of the Act was incorrect.

The Court referred to the deletion in 2008 of the requirement in s30 that at least 85 percent of the activities, measured as either the cost related to the activities or the time expended in respect thereof, are carried out for the benefit of persons in South Africa. The Court also referred to the Explanatory Memorandum relating to the amendment which stated that:

> "Currently, in order for a PBO to qualify as such, it must conduct at least 85 per cent of its public benefit activities for the benefit of persons in the Republic. Given the fact that many PBOs conduct a substantial amount of activities outside South Africa and the fact that foreign PBOs fall outside the South African tax net per *se*, it is proposed that this restriction be removed."

The Court, having cited those provisions, however, made no inference with respect to the provisions. In my view, the only inference that can be made is that the National Treasury wished to remove the restriction on the conduct of activities outside South Africa. If, as the court suggested, it is a requirement for approval under s18A of the Act that all activities of the organisation be carried on in South Africa, the purpose of the removal of the restriction would be undone.

The Court went on to state that the authority to issue tax deductible receipts in terms of s18A of the Act has the effect of reducing the tax base in South Africa. While the statement is arguably correct, it should be noted that s30 of the Act also has the effect of reducing the tax base in South Africa as organisations which qualify for the approval, are exempt from taxes, as set out above. In fact, the provisions of s30 of the Act may have a greater effect on the erosion of the tax base in South. The point, however, is that, despite the erosion of the tax base, the policy of the Government is that philanthropy in the right sectors should be encouraged. No doubt, one reason for that policy is that those organisations ease the Government's burden to provide the help and care rendered by the organisations.

The Court continued to state that "it therefore makes sense that only activities carried on within the Republic should be allowed to reduce the South African tax base." But, as noted above, s30 of the Act, which also reduces the South African tax base, was amended precisely to enable organisations to carry on activities largely, or even mostly outside South Africa – despite the possible increase in the erosion of the tax base.

The Court, effectively, held that an organisation must carry on its activities exclusively in South Africa to qualify under s18A of the Act. With respect, the words of the relevant provision are that the organisation qualifies if it 'carries on in the Republic' the relevant public benefit activity. The words are not unclear or ambiguous. As such, they should be given their ordinary meaning which, I submit, does not include the meaning that it should be carried on exclusively or even mainly in the Republic. If the Legislature had wished to qualify the meaning, it would have inserted words to that effect.

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It should also be noted that paragraph 4(d) of Part II of the Ninth Schedule includes as an activity that qualifies for s18A of the Act "the establishment and management of a transfrontier area, *involving two or more countries...*" (emphasis added). In that case, the activity in fact contemplates that it will be carried on in South Africa and outside South Africa. If the relevant phrase in s18A of the Act should be read as "carries on exclusively in the Republic", no one would be able to qualify under paragraph 4(d).

If the phrase were to bear the meaning ascribed to it by the court it would mean that SARS would have to withdraw the approval of many organisations which do not carry on their activities exclusively in South Africa. For instance, one local organisation which provides disaster relief all over the world, on its website invites donors to apply for receipts in terms of s18A of the Act and, ostensibly, has been approved under that provision.

Finally, s18A of the Act was recently amended (in terms of the Taxation Laws Amendment Act, No 31 of 2013) to enable donors who do not use their deductions in terms s18A of the Act in full during a tax year, to 'roll over' the unused deductions in subsequent tax years.

In my view, this is another indication of the fact that National Treasury wishes to expand, and not restrict the application of s18A of the Act.

If the judgment of the court were allowed to stand, it would have a profound effect on the non-profit sector in South Africa. I understand that the trust is appealing against the judgment.

Ben Strauss

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ENQUIRING ABOUT INQUIRIES IN TERMS OF THE TAX ADMINISTRATION ACT

On 17 February 2014, judgment was handed down in the Western Cape High Court in the matter of *GW van der Merwe & 12 Others v CSARS* (unreported judgment, case number 1984-14). The first applicant was Gary van der Merwe (GVM), who is best known for his involvement in the helicopter industry. He ran the Huey Extreme Club which offered joyrides over the Cape Peninsula in a Vietnam-era Bell Huey chopper. GVM was arrested in 2004 in a joint operation between the South African Revenue Service (SARS) and the Scorpions and faced charges relating to the alleged fraudulent sale of shares in two companies, World On-Line Limited and Wellness International Network, respectively. Additionally, he faces charges relating to the alleged under-declaration of income and fraudulent VAT claims. These charges are still being disputed in court.

The present matter related to an authorisation that SARS had obtained to hold an inquiry in terms of s50 of the Tax Administration Act, No 28 of 2011 (TAA). In terms of s51(1) of the TAA, a judge may grant authorisation for an inquiry, if he is satisfied that there are reasonable grounds to believe that a person has:

(i) failed to comply with an obligation imposed under a tax Act; or

(ii) committed a tax offence; and

relevant material is likely to be revealed during the inquiry, which may provide proof of the failure to comply or the commission of the offence.

GVM, his daughter and 11 other applicants who were affected by the inquiry, brought an application requesting a temporary interdict. The applicants sought an interdict preventing the inquiry pending a review or declaration that the provisions of the TAA, which permit the authorisation of an inquiry nothwithstanding ongoing civil or criminal proceedings, are unconstitutional and invalid. Additionally, the applicants sought an order allowing them access to the court file relating to the authorisation application by SARS, to allow them to prepare for the requested review.

In determining whether the interdict against the inquiry should have been granted on grounds of 'pending' civil or criminal proceedings, the court looked at the meaning of 'pending' in s58 of the TAA. The court ruled that the term meant that an inquiry must continue even during civil or criminal proceedings.

On the second matter relating to access to the court file, it was common cause that SARS refused to grant the applicants access to the court file, subsequent to the granting of the inquiry application. The court found, given that the applicants' attack on the constitutionality of the TAA provision turned on the interpretation of the section and not the contents of the court file and given that the interpretation contended for had no prospect of being upheld, the application for the court file could not succeed.

Interestingly, this matter has drawn considerable press attention, given that preservation orders have been served both on GVM and his daughter, Candice van der Merwe (CVM), who is the second applicant in this matter. It is alleged by SARS that certain monies and assets received by CVM, allegedly for modeling pursuits, may have been given to her by her father in an attempt to avoid the revenue authorities. Time will tell whether the inquiry by SARS will yield the results they are hoping for.

Danielle Botha

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DLA CLIFFE DEKKER HOFMEYR

CONTACT US

For more information about our Tax practice and services, please contact:

Emil Brincker
National Practice Head
Director
T +27 (0)11 562 1063
E emil.brincker@dlacdh.com

Ben Strauss
Director
T +27 (0)21 405 6063
E ben.strauss@dlacdh.com

Danielle Botha
Associate
T + 27 (0)11 562 1380
E danielle.botha@dlacdh.com

Ruaan van Eeden
Director
T +27 (0)11 562 1086
E ruaan.vaneeden@dlacdh.com

Tessmerica Moodley
Associate
T +27 (0)21 481 6397
E tessmerica.moodley@dlacdh.com

Lisa Bruton
Senior Associate
T + 27 (0)21 481 6390
E lisa.bruton@dlacdh.com

Carmen Moss-Holdstock
Associate
T + 27 (0)11 562 1614
E carmen.moss-holdstock@dlacdh.com

Andrew Lewis
Senior Associate
T + 27 (0)11 562 1500
E andrew.lewis@dlacdh.com

Nicole Paulsen
Associate
T + 27 (0)11 562 1386
E nicole.paulsen@dlacdh.com

Heinrich Louw
Senior Associate
T +27 (0)11 562 1187
E heinrich.louw@dlacdh.com

BBBEE STATUS: LEVEL THREE CONTRIBUTOR

JOHANNESBURG

1 Protea Place Sandton Johannesburg 2196, Private Bag X40 Benmore 2010 South Africa
Dx 154 Randburg and Dx 42 Johannesburg
T +27 (0)11 562 1000 **F** +27 (0)11 562 1111 **E** jhb@dlacdh.com

CAPE TOWN

11 Buitengracht Street Cape Town 8001, PO Box 695 Cape Town 8000 South Africa
Dx 5 Cape Town
T +27 (0)21 481 6300 **F** +27 (0)21 481 6388 **E** ctn@dlacdh.com