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TAX & EXCHANGE CONTROL ALERT

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Tax exemption is not a formality – the Tax Court considers the PBO status of a non-profit company

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Tax exemption is not a formality – the Tax Court considers the PBO status of a non-profit company

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In terms of s30 of the Income Tax Act, No 58 of 1962 (Act), an entity can only become a public benefit organisation (PBO) if it meets the requirements in that section and is approved by the South African Revenue Service (SARS) as a PBO. In practice, to be approved as a PBO, an application must be submitted to SARS's Tax Exemption Unit (TEU).

From an income tax perspective, it is beneficial for an entity to be a PBO as its receipts and accruals will be exempt from income tax, to the extent that such receipts and accruals meet the requirements of s10(1)(cN) of the Act. In terms of s10(1)(cN) of the Act, any receipts and accruals derived otherwise than from any business undertaking or trading activity will be exempt from income tax, including for example, donations received by the PBO from its donors. Receipts and accruals derived by a PBO from a business undertaking or trading activity will only be exempt from income tax, if they meet the requirements stipulated in s10(1)(cN)(ii) of the Act.

In the recent Tax Court case of *ABC Company v Commissioner of the South African Revenue Services* (Case No. 14106) (as yet unreported), the Tax Court had to pronounce on whether ABC Company (Taxpayer) was a PBO and whether its application for PBO status should have been approved.

Facts

The Taxpayer is a non-profit company that rents out remodelled apartments for residential accommodation to, *inter alia*,

low and medium income households. The Taxpayer's Memorandum of Incorporation (MOI) provides that one of its primary objects is "the development, holding, letting or other disposal of affordable residential accommodation to and for the benefit of low to medium households".

Since 2012, the Taxpayer has complied with the qualifying criteria for accreditation set out by the Social Housing Regulator Authority (SHRA) and therefore qualifies as a "social housing institution" in terms of the Social Housing Act, No 16 of 2008 (SHA). By qualifying as such, social housing institutions benefit from public funds which subsidise the development costs of the apartments, thereby reducing the debt to be recouped by the Taxpayer through rental receipts.

At issue in this case was whether the Taxpayer was entitled to be approved as a PBO in terms of s30(3) of the Act, and whether it consequently qualified for tax exemption under s10(1)(cN)(ii) of the Act. The Taxpayer argued, among other things, that its status as a social housing institution in terms of the SHA, meant that it automatically qualified for PBO status in terms of the Act.

Judgment

At the outset, the Tax Court considered the Taxpayer's contention that its status as a social housing institution means that it automatically qualifies for PBO status and found that there is no legal basis for such an interpretation of the Act and Schedules to the Act.

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If an accreditation by SHRA automatically gives PBO status to a company, it would confer an undue power pursuant to tax legislation on the SHRA, thereby divesting the Commissioner for SARS of its statutory powers.

It was held that the Act empowers the Commissioner for SARS to decide the approval of an applicant as a PBO. If an accreditation by SHRA automatically gives PBO status to a company, it would confer an undue power pursuant to tax legislation on the SHRA, thereby divesting the Commissioner for SARS of its statutory powers. It was therefore held that an accredited social housing institution that complies with the SHA does not automatically qualify for PBO status in terms of the Act.

Given this finding, it was incumbent on the Court to determine whether the Taxpayer qualified as a PBO in terms of the provisions of the Act.

According to the Tax Court, s30(1) of the Act provides that where a taxpayer is a company, it must meet the following criteria in order to qualify as a PBO. The taxpayer must:

1. Be a non-profit company as defined in the Companies Act, No 71 of 2008;
2. Be an entity which sole or principal object is to carry on 'one or more public benefit activities', as defined in Part I of the Ninth Schedule to the Act or by the Minister of Finance by notice in the Government Gazette; and
3. Conducts its activities in a non-profit manner or with an altruistic and philanthropic intent, which activities are not intended to promote the economic self-interest of any employee or fiduciary of the taxpayer.

Paragraph 3(a) of Part 1 of the Ninth Schedule to the Act defines "one or more public benefit activity" as including:

The development, construction, upgrading, conversion or procurement of housing units for the benefit of persons whose monthly household income is equal to or less than R15,000 or any greater amount determined by the Minister of Finance by notice in the Gazette after consultation with the Minister of Housing.

With reference to points 1 to 3 mentioned above, the Tax Court stated that if a non-profit company's sole or principal object is not to carry on one or more public benefit activities, the non-compliance with the second requirement brings the matter to an end. It is only in the event of compliance with the first and second requirements that the actual activities of the taxpayer must be reviewed in order to establish an entitlement to PBO status.

In determining whether the Taxpayer met the criteria in terms of s30, the Tax Court had to consider whether the Taxpayer's primary object of providing housing "for the benefit of low to medium income households" falls within the ambit of "for the benefit of persons whose monthly income is equal to or less than R15,000" contained in paragraph 3(a) referred to above.

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Taxpayers should bear in mind that in practice and based on recent experience, it may take quite some time before a PBO application is approved by SARS. Fortunately, it is possible for an NPC to be approved retrospectively as a PBO, that is, from the date that it met the requirements of s30 of the Act.

The Tax Court found that the standard contained in the Taxpayer's MOI and the standard set out in paragraph 3(a) differed fundamentally. It was held that the standard of "low to medium income households" is determined with reference to the income of other households and calls for the exercise of a judgment in assessing the factual question. In contrast, the standard conveyed by "equal to or less than R15,000" does not require the exercise of a discretion because reference is made to a specific amount which remains fixed until such time as the Minister of Finance decides to change it.

It was concluded that due to the fact that the standard in the Taxpayer's MOI is imprecise and variable in nature, it cannot fall within the ambit of paragraph 3(a), which is precise and pre-determined. As such, the Court found in favour of SARS and dismissed the Taxpayer's appeal.

(Note: Although the Tax Court only referred to points 1 to 3 mentioned above in its judgment, one should note that there are other requirements that must also be complied with, in order for a NPC to be approved as a PBO. For example, its MOI must contain certain provisions listed in s30(3)(b) of the Act.)

Comment

The judgment in this matter serves as an important reminder that a non-profit company (NPC) is not automatically a PBO and does not automatically qualify for tax exemption in terms of the Act. Pursuant to an NPC being registered with the Companies and Intellectual Property Commission (CIPC), it must submit an application to SARS's TEU for approval as a PBO in terms of s30 of the Act.

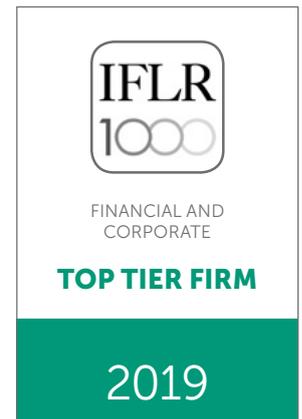
Taxpayers should bear in mind that in practice and based on recent experience, it may take quite some time before a PBO application is approved by SARS. Fortunately, it is possible for an NPC to be approved retrospectively as a PBO, that is, from the date that it met the requirements of s30 of the Act. This means that all receipts and accruals that it derives between the date that it met the requirements of s30(1) and the date that it receives notice from SARS of its PBO approval, can also be exempt from income tax in terms of s10(1)(cN) of the Act.

While this judgment dealt specifically with the PBO approval of an NPC, trusts and associations of persons that meet the requirements of s30 of the Act, can also be approved as PBOs.

Readers who are interested in recent developments regarding PBOs can have a look at our [Tax and Exchange Alert](#) of 16 March 2018.

Louise Kotze and Louis Botha

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