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Public benefit organisations: Proposed new requirements for section 18A receipts

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Understatement penalties and *bona fide* inadvertent errors

As taxpayers may be aware, should they cause or make an "*understatement*", they may be liable to the South African Revenue Service (SARS) for an understatement penalty in terms of section 222 of the Tax Administration Act 28 of 2011 (TAA). This penalty could range from between 10% and 200% of the amount of the shortfall in tax.

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Companies, as organisations designed for profit maximisation, do not necessarily have the mandate or capacity to actively engage in ESG initiatives in an effective manner. A valuable tool available to corporates to address their selected ESG priorities, is the ability to fund organisations that undertake specific or general activities for the public good.

South Africa's tax system includes a special dispensation for organisations which do not have a profit motive and instead are solely or mainly aimed at providing public goods. Public benefit organisations (PBOs) approved by the South African Revenue Service (SARS) are exempt from income tax in recognition of the fact that the income of such entities is being applied to fund public goods, in a manner akin to the government's use of tax revenues.

An important feature of the PBO regime when considering ESG, is that it enables companies to provide donor funding for their selected ESG priorities and receive a tax deduction for such expenditure. This is the case where the PBO to which the company donates has been approved by SARS in terms of section 18A of the Income Tax Act 58 of 1962 (Income Tax Act), and issues the donor with a valid section 18A receipt for the donation.

On 18 November, SARS proposed that additional information be included on section 18A receipts for them to constitute valid receipts entitling the relevant donors to a deduction. Members of the public have until 5 December 2022 to provide SARS with comments on the proposed augmentation of the section 18A receipt requirements.

Public benefit organisations: Proposed new requirements for section 18A receipts

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SOUTH AFRICA'S DEDUCTIBLE DONATION REGIME

It is noteworthy that not only SARS approved PBOs are capable of issuing section 18A receipts. Other institutions that may do so include amongst others the Government of the Republic of South Africa, a SARS approved institution, board or body, and certain specified United Nations entities. However, PBOs are the most prevalent issuers of section 18A receipts and present the most utility for the pursuit of ESG targets by companies.

To be approved as a PBO under section 30 of the Income Tax Act, the applicant must satisfy, *inter alia*, the following requirements:

- the entity must be a non-profit organisation, trust or non-profit company, or a branch of a similar entity established in another jurisdiction where it benefits from an income tax exemption;
- the sole or main object of the entity is the carrying on of one or more public benefit activity (PBA), as listed under the Ninth Schedule to the Income Tax Act;
- all PBAs are carried on in a non-profit manner and with altruistic or philanthropic intent;
- no activity of the entity is intended to promote the economic self-interest of any fiduciary or employee of the entity directly or indirectly, otherwise than by way of reasonable remuneration payable to that fiduciary or employee; and
- each PBA is carried on by that entity for the benefit of, or is widely accessible by, the general public.

An organisation that meets the above requirements and makes an application to SARS for approval as a PBO, may be granted tax exempt status regarding its income. However, this does not enable the PBO to receive donations that are deductible by the donor. To be able to do so, the PBO must additionally be approved for the purposes of section 18A.

Section 18A enables PBOs and other selected entities to issue receipts to donors entitling such donors to a deduction of the amount of their donation. The core requirement for approval under section 18A is that the PBO carries on PBAs noted in Part II of the Ninth Schedule to the Income Tax Act or otherwise approved by the Minister of Finance by notice.

The broad categories of the PBAs listed in Part II of the Ninth Schedule are:

- welfare and humanitarian;
- healthcare;
- education and development;
- conservation, environment and animal welfare; and
- land and housing.

Public benefit organisations: Proposed new requirements for section 18A receipts

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Where a donor has made a donation to an organisation entitled to issue a section 18A receipt, that donor is entitled to a deduction of the amount donated upon submission of a valid section 18A receipt issued by the organisation.

PROPOSED AMENDMENTS TO SECTION 18A RECEIPTS REQUIREMENTS

The requirements for a valid section 18A receipt are contained in section 18A(2) and are as follows:

- the reference number of the PBO or other approved entity issued by SARS for the purposes of section 18A;
- the date of the receipt of the donation;
- the name of the PBO or other approved entity which received the donation, together with an address to which enquiries may be directed in connection to such donation;
- the name and address of the donor;
- the amount of the donation or the nature of the donation (if not made in cash);
- a certification to the effect that the receipt is issued for the purposes of section 18A, and that the donation has been or will be used exclusively for the object of the PBO or approved entity for the carrying on of the relevant PBA; and
- such further information as the Commissioner of SARS may prescribe by public notice.

In its draft notice of 18 November 2022, SARS indicated that the following information would be added to the requirements for a valid section 18A receipt:

- donor nature of person (natural person, company, trust, etc.);
- donor identification type and country of issue (in case of a natural person);
- identification or registration number of the donor;
- tax reference number of the donor (if available);
- contact number of the donor;
- email address of the donor;
- a unique receipt number; and
- trading name of the donor (if different from the registered name).

COMMENT

Public benefit organisations: Proposed new requirements for section 18A receipts

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The ability for companies to select or even create an independent organisation with a specified mandate targeting that company's ESG priorities is a useful mechanism that allows corporates to directly link the utilisation of funds or assets donated by them, with positive public outcomes. The availability of a tax deduction for this expenditure (which may not have otherwise constituted deductible expenditure) is a strong incentive to utilise this avenue to attain a company's ESG goals.

The amendments proposed to the information to be contained in section 18A receipts may be aimed at augmenting the administration of the section 18A regime, as greater information regarding the donor noted on a section 18A receipt would increase the ease with which SARS administers the regime.

Greater transparency in this instance can also be in the donor's interest, as it provides corporates with a verifiable means to highlight their ESG spend. As, the proposed changes would provide a third-party document, which the donating company could choose to use to fly its ESG flag high.

TSANGA MUKUMBA

2022 RESULTS

CHAMBERS GLOBAL 2018 - 2021 ranked our Tax & Exchange Control practice in Band 1: Tax.

Emil Brincker ranked by **CHAMBERS GLOBAL 2003 - 2022** in Band 1: Tax.

Gerhard Badenhorst was awarded an individual spotlight table ranking in **CHAMBERS GLOBAL 2022** for tax: indirect tax. **CHAMBERS GLOBAL 2009–2021** ranked him in Band 1 for tax: indirect tax.

Mark Linington ranked by **CHAMBERS GLOBAL 2017 - 2022** in Band 1: Tax: Consultants.

Ludwig Smith ranked by **CHAMBERS GLOBAL 2017 - 2022** in Band 3: Tax.

Stephan Spamer ranked by **Chambers Global 2019-2022** in Band 3: Tax.

Cliffe Dekker Hofmeyr

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An understatement is defined in section 221 of the TAA as any prejudice to SARS that results from, *inter alia*, failure to submit a return, an omission from a return, an incorrect statement in a return, or simply failing to pay tax if no return is required.

The applicable percentage is determined with reference to a table in section 223, setting out certain categories against which the taxpayer's relevant behaviour or the amount involved must be judged.

It should be appreciated that, once it is established that there was indeed an understatement, the imposition of an understatement penalty by SARS is not a matter for discretion but is in fact mandated by law.

There are only a few circumstances in which a taxpayer may be excused. These are if (i) the understatement results from a *bona fide* inadvertent error; (ii) the taxpayer qualified for relief under the voluntary disclosure programme; or (iii) the taxpayer was in possession of a qualifying tax opinion as contemplated in section 223(3) of the TAA.

WHAT CONSTITUTES A *BONA FIDE* INADVERTENT ERROR?

Our focus in this article is the concept of a *bona fide* inadvertent error.

In SARS' formal *Guide to Understatement Penalties (Issue 2)*, SARS essentially takes the following position.

In the first instance there must have been an error, essentially being a mistake or misconception of some sort. However, it is qualified by two factors, being that the error must be *bona fide*, and inadvertent.

On the meaning of an "*inadvertent*" error, SARS concludes that "*the understatement must result from an unintentional default, an accidental omission, an unplanned statement, an involuntary failure to pay the correct tax*".

On the meaning of "*bona fide*", SARS appears to interpret it as meaning "*genuine*" or "*real*" and is somewhat reluctant to accept the meaning "*good faith*".

In general, SARS is at pains to point out that it is the "*trigger*" that must be *bona fide* inadvertent, and not the person who made the error – divorcing it from the conduct of the taxpayer.

Specifically, "*an inadvertent error is one that does not result from deliberate planning, and a bona fide inadvertent error is one that genuinely does not result from deliberate planning*".

SARS also points out that an error resulting from an opinion that was intentionally sought can never be a *bona fide* inadvertent error.

SARS essentially then concludes that "*it seems likely that the only errors that may fall within the bona fide inadvertent class are typographical mistakes – but only properly involuntary ones*".

Understatement penalties and *bona fide* inadvertent errors

CONTINUED

THE *THISTLE TRUST* CASE

We reported on the case of *Commissioner, SARS v Thistle Trust* (516/2021) [2022] ZASCA 153 in our Tax Alert on 24 November 2022. That alert dealt with the substantive tax issues that were in dispute, but for the purposes of this article, we will only look at the imposition of the understatement penalty that was in dispute in that case.

In the *Thistle Trust* case, the taxpayer had obtained a tax opinion on the specific tax treatment of consecutive or back-to-back distributions by trusts. The taxpayer accepted the position taken in the opinion, and completed and submitted its tax returns on that basis.

SARS disagreed with the position taken by the taxpayer, assessed the taxpayer accordingly, and imposed an understatement penalty.

The Supreme Court of Appeal (SCA) ultimately held that SARS was correct in its assessment to tax, but during the course of the proceedings, it appears that a concession was made by SARS on the issue of the understatement penalty.

The SCA specifically records that:

> *"SARS initially adopted the position that, in the light of the legal opinion, it should be concluded that the Thistle Trust had consciously and deliberately adopted the position it took when it elected to distribute the amounts of the capital gains as it did. However, during the argument before us, counsel for SARS conceded, correctly, that the understatement by the Thistle Trust was a bona fide and inadvertent error as it had believed that section 25B was applicable to its case. Though the Thistle Trust erred, it did so in good faith and acted unintentionally. In the circumstances, it was conceded that SARS was not entitled to levy the understatement penalty."*

The SCA's interpretation of the exemption for *bona fide* inadvertent errors from understatement penalties (agreeing with the concession made by SARS) seems to differ from SARS' interpretation as formulated in its guide.

The SCA appears to suggest that a taxpayer may *"consciously and deliberately"* adopt an incorrect position taken in an opinion, and complete its returns accordingly, and at the same time be regarded as having acted in good faith and unintentionally – qualifying for exemption from understatement penalties.

HEINRICH LOUW

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BBBEE STATUS: LEVEL ONE CONTRIBUTOR

Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

PLEASE NOTE

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