

TAX & EXCHANGE CONTROL

ALERT

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Tax deductible donations to philanthropic and other socially beneficial organisations are a familiar feature of many countries' tax systems – to the extent that such deductible donations can be said to have gained the tinge of infamy in mainstream media. However, the goal of this type of regulation is to incentivise companies and individuals to donate to organisations dedicated to the provision of social goods and insulated from the personal financial benefits which are associated with for-profit enterprises.



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On 9 May 2022, the South African Revenue Service (SARS) issued Binding Private Ruling 371 (BPR 371), dealing with the proposed operating model of a trust that is an approved public benefit organisation (PBO). Specifically, whether the operating model was within the provisions of section 30(1)(c)(i).

BPRs are issued by SARS under Chapter 7 of the Tax Administration Act 28 of 2011. BPRs are published with the consent of the applicant(s) and are only binding upon SARS as regards the taxpayer(s) that applied for the ruling.

BINDING PRIVATE RULING 371

The trust in BPR 371 was established to use the contributions it received exclusively for the benefit of persons in need, in a specified geographical region. The trust was to assist these communities in certain focus areas, including socio-economic development, skills development, job creation and enterprise development.

The trust determined that it would allocate funding to initiatives sourced from an open public call for proposals through established community forums, such as community hall initiatives. Projects would then be identified through a selection process and funded by the trust from available capital.

RELEVANT PROVISIONS OF THE INCOME TAX ACT

The Income Tax Act 58 of 1962 (Act) prescribes the requirements for approval as a PBO in section 30. Public Benefit Organisation is defined in section 30(1), as any organisation which:

- is a non-profit company as defined in the Companies Act 71 of 2008, a trust or an association established in South Africa, or a branch of any tax exempt entity established outside South Africa;
- has as its sole or principal object the carrying on of one or more public benefit activities as defined in the Ninth Schedule to the Act;

- carries out its stipulated public benefit activity in a non-profit manner and with altruistic or philanthropic intent;
- does not promote the economic self-interest of any fiduciary or employee, other than through reasonable remuneration; and
- carries on each public benefit activity for the benefit of, or is widely accessible to, the general public at large, including any sector thereof (other than small and exclusive groups).

The definition of a PBO and approval requirements set out in section 30, work in tandem with section 10(1) (cN) which exempts the receipts and accruals of PBOs from income tax, and section 18A which governs the deductibility of donations to PBOs.

For a PBO to be approved for purposes of section 18A of the Act, it must carry on public benefit activities listed in Part II of the Ninth Schedule to the Act, or it must be a conduit PBO that distributes funds

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to other PBOs carrying on public benefit activities in Part II of the Ninth Schedule.

BPR 371 is an instance where SARS determined that the trust's activities being limited to a specific geographical region was consistent with the requirement that a PBO's public benefit activities be carried on for the benefit of, or be widely accessible to, the general public at large, including any sector thereof (other than small and exclusive groups).

COMMENT

The ability to reliably deduct contributions made to PBOs provides companies with a useful mechanism to ameliorate some of the costs of pursuing environmental, social and governance (ESG) projects which could otherwise be difficult to justify as being deductible ordinary trading expenses. However, companies

should appreciate that only donations made to PBOs approved for purposes of section 18A (read with Part II of the Ninth Schedule) are deductible by the company.

This means that corporates pursuing ESG and other social objectives through projects implemented by a PBO comes with an administrative burden to establish and obtain PBO status. The PBO must continuously comply with the requirement in section 30(1) of the Act and with particular record keeping and reporting requirements, amongst others.

When setting up a PBO to implement ESG projects, companies should be mindful that PBOs are by their nature autonomous entities, separate from the structure and control of a corporate group. For example, under section 30 of the Act no one person (such as the company setting up the

PBO) may solely control the decision-making powers of a PBO. This requires the setting of strong guardrails on the scope of activities to be pursued by the PBO when designing its objects. Paramount in this is ensuring that the PBO's activities fall within Part II of the Ninth Schedule, if the intention is for the PBO to receive donations and issue section 18A certificates enabling the donor to deduct the amount.

The alternative to claiming a deduction under section 18A, is for a company to incur social expenditure and claim it as a deduction under section 11(a) of the Act and other specific deduction provisions of the Act. In this regard, one should consider the judgment in *Warner Lambert SA (Pty) Ltd v CSARS* (277/02) [2003] ZASCA 59 (30 May 2003) and rulings issued by SARS permitting the deductibility of such expenses. Practically, in sectors of the economy

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where social expenditure is a regulatory requirement, the risk that ESG expenditure would be viewed as non-deductible under section 11(a), read with section 23(g) may be lower. In sectors where social contributions are not a regulatory requirement, companies seeking to claim a deduction under section 11(a) face an increased risk that ESG or other social expenditure is deemed non-deductible.

The risk involved in having a deduction (including section 11(a) deduction) disallowed by SARS is evident from recent court decisions such as *CSARS v Spur Group (Pty) Ltd*

[2021] ZASCA 145 and *Clicks Retailers (Pty) Limited v CSARS* [2021] ZACC 11. These judgments remind us that prudence must always be exercised when deductibility is dependent on interpretation of facts through the sometimes opaque lens of provisions of the Act. It may therefore be prudent for companies in sectors with no regulated social spend that wish to pursue appropriate ESG objectives to do so through a PBO. Allowing the company to reliably benefit from a deduction for funding contributed to the PBO pursuing the company's chosen altruistic mission.

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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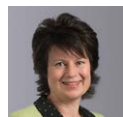
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BBBEE STATUS: LEVEL ONE CONTRIBUTOR

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.

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