Tax & Exchange Control

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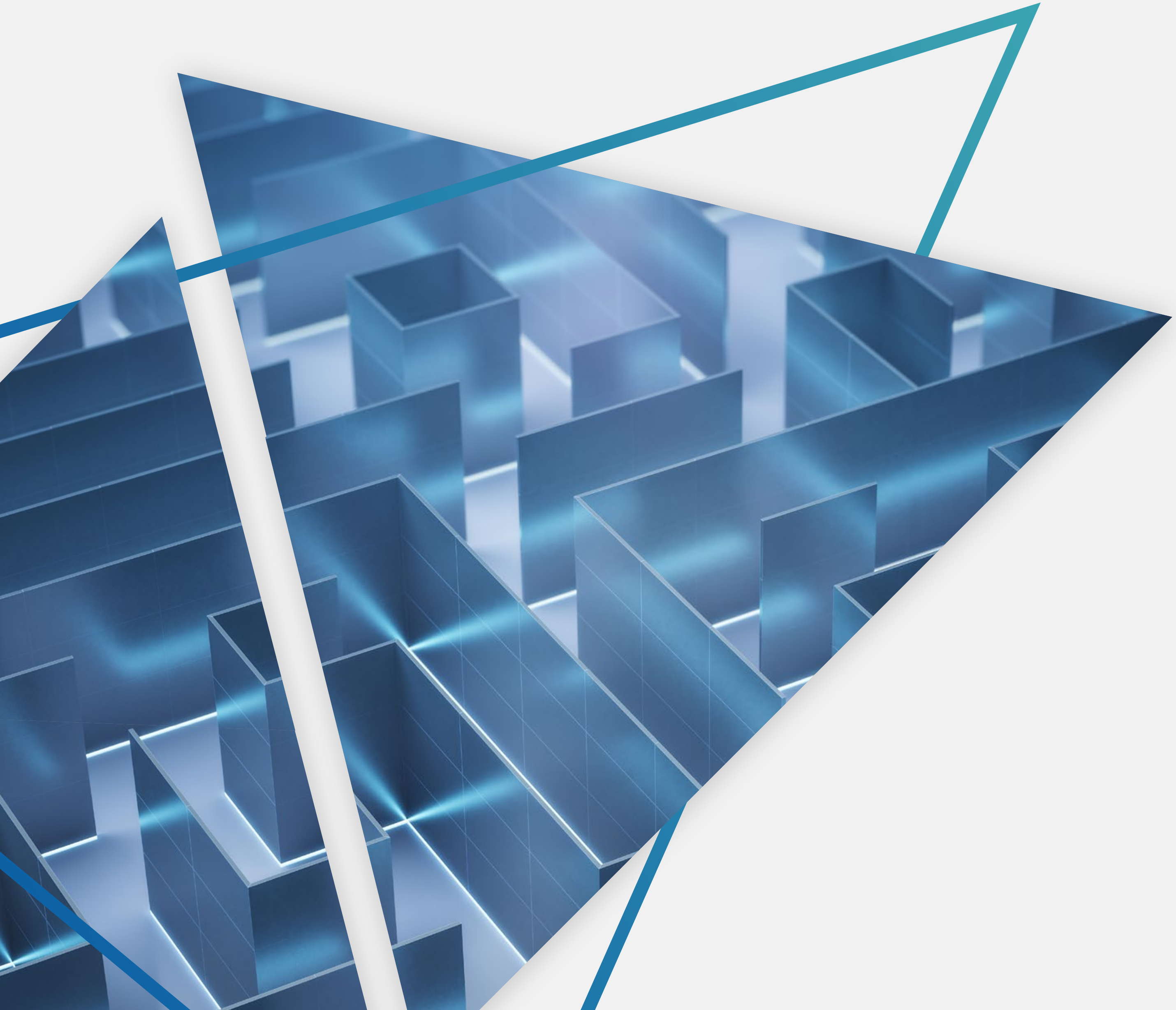

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For more insight into our expertise and services

Solar is dead, long live solar

Renewable energy in South Africa is a hot topic. Not only because South Africa has an energy crisis and climate change needs to be averted, but also because the South African Government is assisting in the transition to a greener, cleaner, and more stable energy supply by, amongst other things, offering favourable tax incentives in this space.

One of the key tax incentives is found in section 12B of the Income Tax Act 58 of 1962 (ITA). The allowance is attractive because renewable energy often requires significant upfront capital outlays that are typically not allowed as an income tax deduction because the costs are capital in nature.

What Section 12B does is provide taxpayers with some relief from tax by providing for an accelerated capital depreciation allowance of 100% or on a 50/30/20 basis, on the costs incurred on plant and equipment utilised in the taxpayer's trade of generating electricity from renewable sources. It also includes costs incurred in respect of the supporting structures. The sister provision of section 12B, section 12BA, includes a temporary separate allowance of 125% of the costs for new and unused assets brought into use for the first time on or after 1 March 2023 but before 1 March 2025. However, one can only claim one of section 12B or section 12BA and not both.

While section 12B, on the face of it, appears relatively simple and straightforward compared to other tax provisions, for the uninitiated, it could result in unwanted consequences and, in a worst-case scenario, the non-application of the allowance. It is no wonder that many taxpayers are approaching the South African Revenue Service (SARS) for rulings on the interpretation of the provision.

The most recent ruling issued by SARS on the topic is Binding Class Ruling 88 (BCR 88) which was issued on 22 February 2024. While rulings issued by SARS are not binding on all taxpayers but only in respect of SARS' dealings with that specific applicant taxpayer, it gives important insight as to SARS' potential interpretation of certain issues and is therefore still valuable to taxpayers.

"Generation assets"

One of the key issues faced by taxpayers is what types of assets factually fall within the allowance. BCR 88 provides some insight into this as it refers to a detailed list of "*generation assets*" that would qualify for the allowance. Apart from the expected assets, such as the solar photovoltaic (PV) panels themselves, battery inverters, battery backup systems and battery units (and their component parts) are also included in the definition of "*generation assets*".

This further reinforces the principle, also dealt with in Binding Class Ruling 85, that if batteries are sufficiently integrated into a renewable energy system and form part of the system's energy continuum, then they will also qualify for the allowance. It recognises that stored energy derived from renewable sources falls within the parameters of the allowance which is important because the sun does not shine at night when energy needs may be at their highest in certain instances.

Solar is dead, long live solar

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Chambers Global 2024 Results

Tax & Exchange Control

Chambers Global 2018–2024 ranked our Tax & Exchange Control practice in: **Band 1**: Tax.

Emil Brincker ranked by Chambers Global 2003–2024 in **Band 1**: Tax.

Gerhard Badenhorst was awarded an individual spotlight table ranking in Chambers Global 2022–2024 for Tax: Indirect Tax.

Stephan Spamer ranked by Chambers Global 2019–2024 in **Band 3**: Tax.

Jerome Brink ranked by Chambers Global 2024 as an "**Up & Coming**" tax lawyer.

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Another interesting aspect is that overhead power infrastructure and towers, including accessories and foundations, are also included in the ambit of "*generation assets*". It is not clear from the ruling what exactly these assets are, why they are needed and how they are integrated into the solar system. However, it certainly builds on the extent of critical assets required to operate a solar system that will qualify for the allowance.

Solar tax incentives utilised by partnerships

BCR 88, however, is not only interesting because of its determinations on section 12B, but also because it deals with the deductibility of expenditure to be incurred, and the limitation of any allowance and deductions claimed by *en commandite* partners (i.e. limited partners) investing in solar PV energy assets.

The taxation of partnerships in South Africa can lead one to murky waters, however, there is some guidance to be found in section 24H of the ITA. It codifies certain aspects of the taxation of partnerships, although it leaves certain factors open to interpretation. It is in this context that it is noteworthy that SARS ruled, amongst others, as follows in BCR 88:

- under section 24H(2) each class member (i.e. limited partner) is deemed to carry on the trade of the partnership which is important because section 12B requires the taxpayer that is claiming the allowance to have carried on a trade; and
- each class member (i.e. limited partner) is entitled to deduct its proportionate share of the partnership's deductions and allowances, including that allowed under section 12B, thereby confirming that each limited partner has co-ownership of the relevant underlying assets which is a prerequisite for the application of the allowance.

What is also interesting to note is that the ruling mentions that once the necessary capital commitments have been secured, the partnership will be closed. It will not be open-ended for further capital contributions by new investors, except where a new limited partner is substituted for an existing limited partner who subsequently withdraws. This is arguably an important differential.

In this regard, it was importantly ruled that new limited partners may claim section 12B(1)(h) allowances in respect of their proportionate interests in the partnership assets acquired, provided that the new limited partner is acquiring and bringing such assets into use for the first time.

Partnerships are an attractive business vehicle in South Africa as they have various commercial benefits. However, the interaction between section 12B and the taxation of partnerships can be complex. BCR 88 assists taxpayers by providing some guidance on the interpretation of these somewhat intricate provisions. Long live solar.

Jerome Brink

Tax treatment of charitable organisations in Kenya: An impending regulatory update

Charitable organisations are entities that operate with an aim to alleviate poverty, relieve public distress, advance religion, advance education, or generally serve the public. They do so without a primary goal of generating profit or personal gain.

In Kenya, charitable activities can be carried out through vehicles such as companies limited by guarantee, charitable trusts, non-governmental organisations (NGOs), and societies. Despite serving a common purpose, each of these is subject to a distinct manner of incorporation and compliance requirements.

In this alert, we focus on their tax treatment. We also highlight the salient features of the draft Income Tax (Donations and Charitable Organisations Exemption) Rules, 2023 (Rules), whose public participation phase closed on 29 December 2023.

The Rules are meant to repeal the Income Tax (Charitable Donations) Regulations, 2007, and provide clarity on the criteria for tax exemption for charitable organisations. Additionally, they specify the criteria for allowing donations made to charitable organisations as tax deductions.

Current tax treatment

Income tax

The general rule in Kenya is that income earned by a charitable organisation is exempt from tax. The criteria to be met is that the organisation should serve a charitable purpose, for the benefit of Kenyans. It should also be established in Kenya, or have its regional headquarters situated in Kenya.

An exemption is obtained by way of application to the Commissioner who, once satisfied, will issue the exemption. It is valid for five years with the possibility of renewal. However, it may be revoked by the Commissioner before the lapse of the five-year period where there is a just cause.

Donations made to charitable organisations are also deductible when computing taxable gains or profits of a person. We have discussed this in more detail in our analysis of the draft Income Tax (Donations and Charitable Organisation Exemption) Rules, 2023

Withholding tax

Charitable organisations are obligated to deduct withholding tax on payments made for specified services that trigger withholding tax. These include management or professional fees, agency fees, training fees, commission, and consultancy fees. Withholding tax rates vary depending on the nature of the transaction and the residency status of the payee.

Value-added tax

The Value Added Tax Act, 2015 (VAT Act) exempts social welfare services provided by religious, educational, welfare, and charitable organisations. The exemption, however, does not apply where such services are rendered by way of business.

The Public Benefits Organisations Act, 2013 (PBO Act) also provides for preferential treatment for public benefit organisations (PBOs) under the VAT Act as well as customs duties in relation to imported goods or services that are used to further their public benefit purposes.

Tax treatment of charitable organisations in Kenya: An impending regulatory update

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It is important to note however, that the PBO Act is yet to take effect as it will come into operation on a date appointed by the Cabinet Secretary by notice in the Kenya Gazette. There have been several High Court judgments ordering the Cabinet Secretary to gazette the commencement date of the PBO Act. However, the Cabinet Secretary is yet to do so.

Employment taxes and statutory deductions

Employees of charitable organisations are not exempt from tax. Pay-as-you-earn (PAYE) on their earnings is deducted and remitted to the Kenya Revenue Authority by the ninth day of each month. Charitable organisations also deduct and remit mandatory deductions such as the National Social Security Fund, National Industrial Training Authority levy, National Hospital Insurance Fund, and the housing levy.

It is important to note that the National Hospital Insurance Fund Act, No. 9 of 1998 was repealed in 2023 following the enactment of the Social Health Insurance Act, 2023, which establishes a new health fund – the Social Health Insurance Fund (SHIF). Once the enactment of its associated regulations is completed, charitable organisations will be responsible for deducting the specified portion of their employees' income and remitting it to the SHIF.

It is also important to highlight that charitable organisations are not exempt from the housing levy that is currently being challenged in court.

The draft Income Tax (Donations and Charitable Organisation Exemption) Rules, 2023

According to section 15(2) (w) of the Income Tax Act Cap 470, any donation made to a qualifying charitable organisation is an allowable deduction when computing taxable income or gains. Claims for such donations are made to the Commissioner, accompanied by proof, i.e. the receipt issued and certified by the recipient of the donation. The receipt should contain the recipient's details, including its Personal Identification Number, the date, as well as the purpose of the donation.

The Rules aim to shed light on how to determine whether an organisation has been set up for charitable purposes, thereby qualifying it for tax exemption and whether a donation to a charitable organisation qualifies for a tax deduction.

An organisation will be deemed to have been set up for charitable purposes if: (i) it is organised and operated solely for charitable purposes; and (ii) its charitable purpose is directed towards public benefit. In this respect, a charitable organisation that excludes the poor or is based on personal connections such as family would not qualify for an exemption.

Organisations that engage in illegal activities such as terrorism, money laundering, tax avoidance, or fraud will also not be exempt.

Tax treatment of charitable organisations in Kenya: An impending regulatory update

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Band 1 Tax

It is important to note that the Rules propose to limit the amount of funds that a charitable organisation may hold over a three-year period. Specifically, a charitable organisation cannot retain more than an average of 15% of its funds over three consecutive years without directing them towards a charitable purpose.

Obtaining an exemption

The process will entail making an application to the Commissioner in the prescribed form, accompanied by the required documents, which include the organisation's constitution, trust deed, and certified copy of registration documents, among others. Upon compliance with all registration requirements, the Commissioner will issue a tax exemption certificate valid for a period of five years. Where declined, the applicant will receive a written notification along with the reasons for the decision.

All decisions in this regard will be appealable to the Tax Appeals Tribunal.

It is important to note that an organisation will need to have been in operation for a minimum of one year to apply for an exemption. Renewal applications, on the other hand, will be submitted at least six months before the expiry of the existing certificate.

Allowability of donations made to charitable organisations

To qualify for a tax deduction, donors will be required to provide the Commissioner with proof of the donation and utilisation by the recipient. Donations should further take the form of non-refundable cash to the donor and should not confer any form of benefit on the donor, or any person associated with them.

Importantly, donations will not be revoked once conferred upon a charitable organisation unless approved by the Commissioner. In such a case, the tax arising shall be due and payable.

Commentary and conclusion

The Rules are welcome, as they seek to clarify the criteria for eligibility of a charitable organisation for tax exemption. They explicitly outline the factors to be considered in evaluating whether an organisation aligns with charitable purposes for public benefit and clarify the qualifications that a donation should meet to be allowed as a deduction for purposes of computing a person's taxable income. They further clarify the procedure and documentation required when seeking an exemption.

In an attempt to mitigate tax avoidance within the charitable sector, the Rules also mandate the substantiation of claims of donations or activities related to charity.

We note the intended limitation of the amount of funds that a charitable organisation may hold over a three-year period, and hold the view that such limitation may hinder organisations from building up surplus funds for future use.

We will wait to see whether any revisions will be made to the final version of the Rules.

Alex Kanyi and Judith Jepkorir

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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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