

**THE TAX IMPLICATIONS OF PROFIT SHARE ACCRUAL FOR PUBLIC
BENEFIT ORGANISATIONS IN SOUTH AFRICA**

by

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PLAGIARISM DECLARATION

I, Ingrid Elizabeth Lestrade (Student number: 34100660), herewith declare that this dissertation titled

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ABSTRACT

Section 10(1)(cN) of the Income Tax Act 58 of 1962 (the Act) in South Africa makes provision for approved Public Benefit Organisations (PBOs) in South Africa to enjoy preferential tax treatment. An organisation is approved as a PBO according to the requisites in section 30 of the Act. Accordingly, approved PBOs enjoy partial exemption from Capital Gains Tax (CGT). Income generated from trading activities must meet specific criteria to enjoy preferential tax treatment. One of the restrictions of this section is that an approved PBO may never have as its sole or primary object the operation of a commercial business to fund their public benefit activity. The South African non-profit sector continues to struggle financially, despite the progressive development of the tax legislation since 2000. The South African Revenue Service (SARS) believes that changes made at the commencement of 2000 to the Act that applies to approved PBO's, are sufficient to strengthen the financial resources of the non-profit sector. However, the Legal Resources Centre believes that the changes made to the Act imbed a dependence on sporadic donor funding.

After 1994, several nonprofit organisations that offered much needed socio-economic services to various South African communities, announced that they were struggling financially. Rape Crisis Cape Town was established in Cape Town in 1976 to help survivors of rape and sexual violence. In 1987, the Institute for Democracy in South Africa (IDASA) was set up to monitor the quality of democracy and hold the decision-makers accountable in Southern Africa. Both organisations made public announcements that they were struggling financially, and since then, IDASA has closed its operations in South Africa, and Rape Crisis Cape Town continues to struggle financially.

South Africa's non-profit sector finds its origin in the UK. The UK has implemented and changed its income tax legislation over a more extended period than South Africa. This research undertakes a comparative study between South Africa's PBOs and registered Charities in the United Kingdom, emphasising England and Wales. It critically analyses the similarities and differences between PBOs and Charities with a specific focus on business undertakings and trading activities to increase the

finances of the non-profit sector. One of the shortfalls of the study is that South Africa has a limited number of decided cases and research articles assessing this topic.

This study highlights the complementary link between profit share accrual of PBOs and the basic requirements, conditions, and nature of these entities to address the social and economic challenges highlighted in the National Plan. There is not enough existing case law in which the courts adequately define concepts like “income”, “expenditure”, “surplus”, “profit” and “accrual” for PBOs. The study concludes by discussing the lessons learned from Charities in England and Wales, and it makes recommendations to the South African government for future implementation.

KEYWORDS

Public Benefit Organisations – Public Benefit Activity - income – trade – funding – charities – charity business undertaking – receipts and accruals - profit share accrual – income tax – charitable purpose – charitable trade – non-profit organisations – non-charitable trading

LIST OF ABBREVIATIONS

BEE: Black Economic Empowerment
CASC: Community Amateur Sports Club
CGT: Capital Gains Tax
CDRA: Community Development Resource Association
CDW: Catholic Welfare and Development
CIO: Charitable Incorporated Organisation
CTA: Corporation Tax Act 2010
DTC: Davis Tax Committee
DSD: Department of Social Development
EU: European Union
GASDS: Gift Aid Small Donations Scheme
GEAR: Growth, Employment, and Redistribution Strategy
HMRC: Her Majesty's Revenue and Customs
IDASA: Institute for Democratic Alternative for South Africa later known as Institute for Democracy in South Africa
ITA: Income Tax Act 2007
IRP5: Employee tax certificate
ITTOIA: Income Tax (Trading and Other Income) Act 2005
NPC: Non-profit company
NPO: Nonprofit organisation
NPO Act: Nonprofit Organisations Act 71 of 1997
NGO: Nongovernmental Organisation
PBA: Public Benefit Activity
PBO: Public Benefit Organisation
PAYE: Pay as You Earn
RDP: Reconstruction and Development Programme
SARS: South African Revenue Service
SCIO: Scottish Incorporated Organisation
SETA: Sector Education and Training Authority
STC: Secondary Tax on Companies
STT: Security Transfer Tax

TCGA: Taxation of Chargeable Gains Act 1992

TEU: Tax Exemption Unit

The Act: Income Tax Act 58 of 1962

UK: United Kingdom

UIF: Unemployment Insurance Fund

VAT: Value-added tax

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CHAPTER 1

INTRODUCTION TO DISSERTATION

1.1 Introduction

South Africa has a large¹ and growing² non-profit sector. The Department of Social Development (DSD) registered 249 833 Nonprofit Organisations (NPOs) in South Africa.³ Another 5 080 new applications are in the process of being assessed for registration.⁴ The number of registered NPOs has increased by 96 156 since the 2015/2016 financial year in South Africa.⁵ NPOs are organisations formed as voluntary associations, registered as trusts or nonprofit companies and are established for a public purpose.⁶ If any of the mentioned organisations want to enjoy preferential tax treatment, it has to, in addition, apply to the South African Revenue Service (SARS) for approval as a Public Benefit Organisation (PBO) in terms of section 30 and section 10(1)(cN) of the Income Tax Act 58 of 1962.⁷ The SARS website is not clear on how many approved PBOs there are in South Africa, but to date, a total number of 26 739 organisations have been approved to furnish section 18A tax certificates to their donors.⁸ The number of approved PBOs under the provisions of section 18A of the Income Tax Act increased with 3 184 from 23 555 recorded on 9 November 2019 to 26 739 in October 2021.⁹

¹ Swilling & Russel 2002 *Centre for Civil Society* University of Natal 21.

² The 2015/2016 State of South African Registered Non-profit Organisations in terms of the Non-profit Act 71 of 1997 March 2016 published by the Department of Social Development of the Republic of South Africa. Report from the National NPO Database states that there were 153 677 registered Non-profit Organisations since the inception of the Non-profit Organisations Act in 1997. The figure implies a growth rate of about 12.6% from 136 453 reported in the previous year.

³ Department of Social Development <http://www.npo.gov.za/> (Date of use: 17 October 2021).

⁴ Department of Social Development <http://www.npo.gov.za/> (Date of use: 17 October 2021).

⁵ Department of Social Development 2015/2016 State of South African Registered Nonprofit Organisations issued in terms of the Non-profit Organisations Act 71 of 1997 "A report from the national database" March 2016 4. <https://conclusive.co.za/wp-content/uploads/2018/12/sa-npo-register-2015-2016.pdf> (Date of use: 26 September 2022).

⁶ Section 1(1)(x) of the Nonprofit Organisations Act 71 of 1997.

⁷ Section 30 of the Income Tax Act 58 of 1962.

⁸ <https://www.sars.gov.za/businesses-and-employers/tax-exempt-organisations/approved-section18a-pbos/> (Date of use: 17 October 2021).

⁹ <https://www.sars.gov.za/businesses-and-employers/tax-exempt-organisations/approved-section18a-pbos/> (Date of use: 9 November 2019 and 17 October 2021). Please fix the indent here.

One of the primary and main objectives of the South African tax system is to generate income to pay for government expenditure. Responding to learning and culture (R402.9 billion), social development (R335.2 billion) and health (R248.8 billion) needs in South Africa are some of the major expenditures of the government.¹⁰ SARS acknowledged that the non-profit sector in South Africa fulfils a considerable task to help government address the socio-economic needs of its population.¹¹ Despite this, the non-profit sector struggles to survive financially and cannot assist government in addressing the social and development needs.¹² The Davis Tax Committee was an advisory committee that made recommendations to the Minister of Finance about any tax policy proposals that should be adopted during the standard budgetary and legislative processes.¹³ Any tax policy proposals that the Minister of Finance announces are subject to public consultations and Parliamentary oversight before it is adopted.¹⁴ The Davis Tax Committee highlighted the need to clarify South African law regarding the “trading” requirement of PBOs.¹⁵ SARS claims that many PBOs fail to comply with all the requirements for a trading activity to enjoy tax exempted status.¹⁶ It further contends that PBOs do not amend their founding documents within the requisite twelve months’ period to include the provisions of section 30 of the Act to enjoy preferential tax treatment.¹⁷ The commercialisation of fundraising is another primary concern for SARS.¹⁸

The National Treasury of South Africa does not oppose a PBO augmenting its income but maintains that its approach ensures that a PBO does not enjoy an unfair advantage when competing with commercial entities in business undertakings or trading activities.¹⁹ PBOs primary challenge is to increase their income because the reliance on rapidly declining donor funding makes such organisations vulnerable

¹⁰ <http://www.treasury.gov.za/documents/national%20budget/2021/review/FullBR.pdf> (Date of use: 26 September 2022).

¹¹ <https://www.sars.gov.za/businesses-and-employers/tax-exempt-organisations/> (Date of use: 10 January 2022).

¹² Maboya, M & McKay, T 2019 The financial sustainability challenges facing South African nonprofit sector The Journal for Transdisciplinary Research in Southern Africa 15(1), a693.

¹³ Davis Tax Committee: Public Benefit Organisations Report: March 2018.

¹⁴ <https://www.taxcom.org.za/termsreference.html> (Date of use: 10 January 2022).

¹⁵ Davis Tax Committee: Public Benefit Organisations Report: March 2018 10.

¹⁶ Davis Tax Committee: Public Benefit Organisations Report: March 2018 10.

¹⁷ Davis Tax Committee: Public Benefit Organisations Report: March 2018 11.

¹⁸ Davis Tax Committee: Public Benefit Organisations Report: March 2018 11.

¹⁹ Davis Tax Committee: Public Benefit Organisations Report: March 2018 16.

and weak.²⁰ An increase in inequality, poverty, and unemployment is a result of a weakening non-profit sector.²¹ South Africa has recorded its highest unemployment rate of 34.9%, which is the highest comparable figure since 2008.²² However, the latest available report on the statistics of the non-profit sector for South Africa, 2010 - 2014, stated that the non-profit sector generated in 2014 only 2.6% of its total income from business undertakings or trading activities.²³ The report stated further that the South African government provided 44.3% of the total income of the non-profit sector.²⁴ The non-profit sector remains financially vulnerable because it is heavily reliant on funding sources from the government and international donors.²⁵ The government and international donors have shifted their funding priorities leaving the non-profit sector very vulnerable and, even more so, the communities they serve.²⁶

This study discusses the background and developments in the Income Tax Act 58 of 1962 with a primary focus on the requirements, conditions and applications of profit share accrual and how it applies to PBOs in South Africa. In addition, it compares the similarities and differences of the requirements, conditions and applications of the concept of trade of PBOs and Charities in England and Wales. Finally, the study highlights some lessons learned and makes a few recommendations.

²⁰ Karen Nelson "The Taxation of NPOs in South Africa – Rapid Change after a decade of lobbying" 2000 *The International Journal of Not-for-Profit Law* volume 3 issue 1 September 2000. <https://www.icnl.org/resources/research/ijnl/the-taxation-of-npos-in-south-africa-rapid-change-after-a-decade-of-lobbying> (Date of use: 28 September 2022).

²¹ Pillay, Gnanam, and Sylvia Kaye. "Exploring Social Entrepreneurship for the Creation of Sustainable Livelihoods in South Africa." *Entrepreneurship: Concepts, Methodologies, Tools, and Applications*. IGI Global, 2017. 1010-1036.

²² <https://tradingeconomics.com/south-africa/unemployment-rate> (Date of use: 22 January 2022).

²³ Statistics South Africa Statistics of the non-profit sector for South Africa, 2010 – 2014 (February 2017) 16. <https://www.statssa.gov.za/publications/D04072/D040722010.pdf> (Date of use: 28 September 2022).

²⁴ <https://www.statssa.gov.za/publications/D04072/D040722010.pdf> (Date of use: 22 January 2022).

²⁵ Mazibuko, F.D. (2013). The role of non-governmental organisations (NGO's) in educational advancement in developing countries: The South African experience. Trust for Educational Advancement in South Africa (TEASA).

²⁶ Bose, B. (2015). Effects of non-profit competition on charitable donations., University of Washington-Seattle Working Paper.

1.2 The development of charitable organisations in South Africa

The South African non-profit sector stems from the charitable work done in England and Europe from the 18th century onwards.²⁷ Before that time, charitable work was in the hands of the churches and wealthy benefactors.²⁸ In the Enlightenment era, charitable work spread and flourished. Interested parties of benefactors gathered around a particular social need or cause to provide relief to the disadvantaged.²⁹

Historically, 'charities' provided services that were not met by the government.³⁰ Charitable organisations, later called Nonprofit Organisations (NPOs), proved that a need existed for housing for the poor, support for the blind and care for orphans.³¹ Some of these services were later taken over by the government that enacted legislation to provide social housing and grants for the disabled.³²

In South Africa, the response to social needs started in the same way with groups of people gathering in response to a particular social condition or need.³³ Given the history of South Africa, it was inevitable that charitable beneficence was directed initially by white people with money to the needs of the white community.³⁴ Driven by the English tradition, the work was extended amongst the poor of other ethnic groups.³⁵

In a country where economic inequality was the order of the day, it was inevitable that the needs of the poor and disadvantaged were enormous. The charitable response was therefore tremendous, but uneven.³⁶ South Africa's civil society,³⁷ also commonly referred to as the NPO or Nongovernmental (NGO) sector, plays a vital and often an unacknowledged development role today.³⁸ Despite a liberal

²⁷ Patel *Social Welfare & Social Development: In South Africa* 32.

²⁸ Patel *Social Welfare & Social Development: In South Africa* 32.

²⁹ Patel *Social Welfare & Social Development: In South Africa* 66.

³⁰ Wyngaard 2013 *The International Journal of Not-for-Profit Law* 5.

³¹ Patel *Social Welfare & Social Development: In South Africa* 33-34.

³² Patel *Social Welfare & Social Development: In South Africa* 66.

³³ Patel *Social Welfare & Social Development: In South Africa* 32.

³⁴ Patel *Social Welfare & Social Development: In South Africa* 32-35.

³⁵ Graham 2008 *National Development Agency of South Africa* 15.

³⁶ Swilling and Russel 2002 *Centre for Civil Society* University of Natal 21.

³⁷ Korkunov *General Theory of Law* 330.

³⁸ Graham 2008 *National Development Agency of South Africa* 11.

South African Constitution,³⁹ discrimination and inequality still proliferate in the country.⁴⁰ The South African non-profit sector required regulation and the Nonprofit Organisations Act 71 of 1997 (NPO Act) was promulgated to address this need.⁴¹

In 1994, the South African government devoted itself to the Reconstruction and Development Programme (RDP)⁴², which created an essential role for NPOs in the spheres of development.⁴³ The central role of NPOs, however, had to be combined with a dominant role for the government that is often expressed in neo-Keynesian⁴⁴ terms.⁴⁵ The Neo-Keynesian theory believed that government must form partnerships with NPOs for delivery of its social services and welfare.⁴⁶ It believed, unlike the Keynesian theory, that the government must take full responsibility for the implementation of social and welfare services.⁴⁷ In 1996, a neo-liberal macro-economic programme called the Growth, Employment and Redistribution Strategy (GEAR) replaced the government's RDP.⁴⁸ GEAR outlined the roles for economic growth and service delivery in the business sector and poverty alleviation for the non-profit sector.⁴⁹

The Minister of Social Development, the late Dr Zola Skweyiya, in 2001⁵⁰ explained that:

³⁹ Section 18 of The Constitution of the Republic of South Africa, 1996.

⁴⁰ The National Development Plan 230-24.
https://nationalplanningcommission.files.wordpress.com/2015/02/ndp-2030-our-future-make-it-work_0.pdf (Date of use: 16 October 2022).

⁴¹ Wyngaard 2013 *The International Journal of Not-for-Profit Law* 5.

⁴² Reconstruction and Development Fund Act 7 of 1994.

⁴³ O'Melly 1995 *African Communist Journal* 9.

⁴⁴ Keynesian economics are macro-economic theories developed by JM Keynes during the 1930s that explained the total spending in the economy and its effects on output and inflation. Keynes developed these theories to understand the Great Depression. Central to his theories, Keynes believed that if the government's expenditure is increased and taxes are lowered, it would stimulate more demand and therefore pull the global economy out of the depression state at the time. Neo-Keynesian theories were developed in the first half of the 1950s, and this school of thought looks at the challenges of economic dynamics and economic growth <https://www.investopedia.com/terms/k/keynesianeconomics.asp> (Date of use: 16 October 2022).

⁴⁵ Burger and Du Plessis 2013 *IGI Global* 30-48.

⁴⁶ Swilling and Russel 2002 *Centre for Civil Society* University of Natal 14.

⁴⁷ Swilling and Russel 2002 *Centre for Civil Society* University of Natal 14.

⁴⁸ Knight <http://richardknight.homestead.com/files/sisaecconomy.htm> (Date of use: 9 August 2020).

⁴⁹ Kraak and Colling *Development Update* 3.

⁵⁰ Barnard and Terreblanche PRODDER: The South African development directory 2001 edition (Pretoria, Human Sciences Research Council, 2001).

The basic twin expectations of government are that nonprofit organisations will firstly act as monitors of the public good and safeguard the interests of disadvantaged sections of society. This performance of a social watch role requires both transparency and accountability of nonprofit organisations. The government's second expectation is that nonprofit organisations will assist in expanding access to social and economic services that create jobs and eradicate poverty among the poorest of the poor. This requires cost effective and sustainable service delivery.⁵¹

The main reasons for the formation of an NPO Act have been to foster an environment in which NPOs⁵² can thrive, set up regulatory and administrative frameworks in which NPOs can function⁵³

Section 3 of the NPO Act states that:

Within limits prescribed by law, every organ of state must determine and co-ordinate the implementation of its policies and measures in a manner designed to promote, support and enhance the capacity of nonprofit organisations to perform their functions.⁵⁴

The State established a Director for Nonprofit Organisations⁵⁵ (NPO Directorate) that is located inside the Department of Social Development (DSD).⁵⁶ The Director of the NPO Directorate enter and maintain information such as the founding document, annual narrative reports and financial statements of all registered NPOs into a register⁵⁷ which is accessible to the public.⁵⁸ The fact that the public can access the said documentation of NPOs propels these type of organisations into a public system.⁵⁹

A registered NPO does not automatically enjoy preferential tax treatment under the Income Tax Act 58 of 1962 (the Act) unless it applies to the South African Revenue Service (SARS) to be approved as a Public Benefit Organisation (PBO).⁶⁰ The enjoyment of preferential tax treatment in terms of Section 30 and Section 10(1)(cN) of the Act is only possible if organisations meet specific conditions and requirements

⁵¹ Daniel, Habib and Southall (eds) *The State of the Nation: South Africa 2003 – 2004* 227.

⁵² Section 1 of the Nonprofit Organisations Act 71 of 1997.

⁵³ Preamble to the Nonprofit Organisations Act 71 of 1997.

⁵⁴ Section 3 of the Nonprofit Organisations Act 71 of 1997.

⁵⁵ Section 4 of the Nonprofit Organisations Act 71 of 1997.

⁵⁶ Section 4 of the Nonprofit Organisations Act 71 of 1997.

⁵⁷ Section 24 of the Nonprofit Organisations Act 71 of 1997.

⁵⁸ Section 25 of the Nonprofit Organisations Act 71 of 1997.

⁵⁹ Section 2(d) of the Nonprofit Organisations Act 71 of 1997.

⁶⁰ Section 30 read together with section 10(1)(cN) of the Act.

that will be further elaborated on in subsequent chapters of this document. A PBO may undertake a business or trading activity provided that such activity falls within one of four categories set out in section 10(1)(cN)(aa)-(dd) of the Act and which forms the basis of this research.⁶¹

SARS highlights the importance of South African nonprofit organisations in the following statement:

Nonprofit organisations play a significant role in society as they undertake a shared responsibility for the social and development needs of the country thereby relieving the financial burden that otherwise falls on the State. Preferential tax treatment is designed to assist nonprofit organisations by supplementing their financial resources and providing them with an enabling environment in which to achieve their objectives.⁶²

One significant challenge⁶³ for NPOs is to find creative means to boost their income to supplement donor funding.⁶⁴ That is, to make certain that the socio-economic rights,⁶⁵ enshrined in the South African Constitution, 1996, do not continue to remain unreachable for a considerable majority of South Africans.⁶⁶

The Legal Resources Centre (LRC),⁶⁷ argues that the restrictions on trading activities in terms of the provisions contained in section 10(1)(cN)(ii)(aa)-(dd) of the Act are not encouraging the economic sustainability of PBOs.⁶⁸ The said restrictions entrench dependence on sporadic funding from donors. The current tax system promotes sporadic, irregular donations and a reformed system would help stabilise PBOs' planning and activities.⁶⁹ The LRC contends that instead of encouraging

⁶¹ Section 10(1)(cN)(ii)(aa)-(dd) of the Act.

⁶² SARS Tax Exemption Guide for Public Benefit Organisations in South Africa Issue 5 26 January 2017 2.

⁶³ Davis <https://www.dailymaverick.co.za/article/2012-10-23-the-great-ngo-funding-crisis-part-ii/> (Date of use: 16 October 2021).

⁶⁴ http://www.ngopulse.org/sites/default/files/coalition_report.pdf (Date of use: 16 October 2021).

⁶⁵ Sections 25, 26, 27 and 29 of The Constitution of South Africa, 1996.

⁶⁶ http://www.ngopulse.org/sites/default/files/coalition_report.pdf (Date of use: 16 October 2021).

⁶⁷ The Legal Resources Centre is a registered NPO that focuses on public interest human rights cases in South Africa. LRC was founded in 1979 by Arthur Chaskalson and Felicia Kentridge who believed that lawyers must play a critical role and take a specific responsibility to help fight gross injustice. <http://lrc.org.za/about/history/> (Date of use: 16 October 2021).

⁶⁸ <https://static.pmg.org.za/docs/2003/appendices/031023npp.htm> (Date of use: 22 October 2022).

⁶⁹ Honey *New Tax Law for South African Non-Profit Organisations* 14.

financial sustainability, the Act harshly limits PBOs to augment their income out of trading activities because PBOs are more concerned with adhering to the limitations contained than maximising its benefits.⁷⁰ The LRC and the Non-profit Partnership claimed that the prevention of possible abuse when raising additional funds through income deriving from trading activities of PBOs were addressed in the different subsections of section 30 of the Act.⁷¹ They suggested that the PBOs should not be charged with a tax levy if its income from trading activity was more than *R100 000 per annum or 50% gross receipts, whichever is greater*.⁷² The second recommendation was that PBOs must not be liable for income tax from trading activities or from charging fees if such income is less than 50% of the organisation's gross receipts per annum.⁷³ Section 10(1)(cN)(ii)(dd) of the Act makes provision for *5 per cent of the total receipts and accruals per annum or R200 000, whichever is greater*.⁷⁴

PBOs must adapt to the existing funding climate that obliges them to supplement their income from donors with income from trading activities.⁷⁵ In addition, PBOs must also deal with a more diverse funding base that requires multiple objectives and accountability procedures.⁷⁶

The exemption contained in section 10(1)(cN)(ii)(aa) of the Act⁷⁷ interprets the inclusion of the words "sole and principal object" to mean that a PBO may not have the effectuation of a commercial business activity⁷⁸ to fund a Public Benefit Activity (PBA) as its sole or principal object.⁷⁹ The carrying on of PBAs must always take

⁷⁰ <https://static.pmg.org.za/docs/2003/appendices/031023npp.htm> (Date of use: 5 November 2022).

⁷¹ <https://static.pmg.org.za/docs/2003/appendices/031023npp.htm> (Date of use: 5 November 2022).

⁷² <https://static.pmg.org.za/docs/2003/appendices/031023npp.htm> (Date of use: 5 November 2022).

⁷³ <https://static.pmg.org.za/docs/2003/appendices/031023npp.htm> (Date of use: 5 November 2022).

⁷⁴ Section 10(1)(cN)(ii)(dd) of the Income Tax Act 58 of 1962.

⁷⁵ <https://static.pmg.org.za/docs/2003/appendices/031023npp.htm> (Date of use: 5 November 2022).

⁷⁶ Dhunpath 2004 (3) *International Journal of Knowledge, Culture and Change Management* 1109-1124.

⁷⁷ Section 10(1)(cN)(ii)(aa) of the Act.

⁷⁸ SARS Interpretation Note 24 Issue 4 12 February 2018 3.

⁷⁹ SARS Interpretation Note 24 Issue 4 12 February 2018 4.

preference over any trading activity of a PBO.⁸⁰ It was to avoid “unfair competition” with other taxable entities.⁸¹ Organisations find it challenging to generate income and become financially sustainable when they must rely less on donor funding.

The taxation on the income of PBOs in the current economic environment poses some challenges for the survival of such organisations in South Africa. Approved PBOs must remain true to its objectives that are of a “service”,⁸² and “not-for-profit” character. The challenge is to continue this inherent nature and expand its services within the parameters of the existing tax legislation. The administration of PBOs must understand the implications of the tax legislation of South Africa to avoid losing its preferential tax treatment.⁸³ The management must clearly understand the limitations when PBOs undertake business or trading activities to supplement their income and to satisfy donor requirements.

1.3 Aim / purpose of study

The purpose of this research is to critically study and examine the conditions and requirements of the trading activities of Public Benefit Organisations (PBOs) in so far as it relates to Section 10(1)(cN)(ii)(aa) - (dd) of the Act the Income Tax Act 58 of 1962.

There appear to be significant variations in the tax legislation. Given the South African PBOs’ reliance on donations for their survival, a review of international experience could inform SARS in the implementation of national policies more conducive to greater financial sustainability and independence for PBOs.

1.4 Assumptions

It is assumed that PBOs in South Africa want to increase their financial resources and that such organisations want to sustain their services for years to come. It is furthermore assumed that the services provided to the South African population are necessary to help improve the people’s living conditions.

⁸⁰ SARS Interpretation Note 24 Issue 4 12 February 2018 5.

⁸¹ SARS Interpretation Note 24 Issue 4 12 February 2018 7.

⁸² National Development Plan of South Africa 2012 334.

⁸³ SARS Interpretation Note 24 Issue 4 12 February 2018 8.

1.5 Comparative study

This research undertakes a comparative study between the benefits and limitations of the income tax legislation as they affect South African PBOs and Charities in the United Kingdom (UK), more specifically in England and Wales. It will specifically look at how the tax legislation in the different countries encourages NPOs and Charities to become financially self-sustainable. The research will also highlight the restrictions and challenges inherent to each country.

There appear to be significant variations in the tax legislation of the countries. An example is found in section 10(1)(cN)(ii)(aa) - (dd) of the Act which restricts the annum income of a PBO that is generated from undertaking any business or trading activity.⁸⁴ Given the South African PBOs' reliance on donations for its survival, a review of international experience could inform the South African National Treasury in the implementation of national policies that are more conducive to greater financial sustainability and independence for PBOs.

1.6 Methodology

The methodology of this research is a literature review of legislation, case law, journal articles and books. The focus of the research is the review of existing literature in so far as it relates to critically comparing the implications of profit share accrual for South African Public Benefit Organisations and Charities in the United Kingdom and more specifically in England and Wales. This research is therefore mainly library based and includes the consultation of relevant and up-to-date electronic articles. The available literature on the tax implications of South African Public Benefit Organisations is limited and consequently very few books are written on this subject. This study accentuates the exigency for further research on this subject because it will help to strengthen a very fragile, yet vital, South African non-profit sector.

⁸⁴ Section 10(1)(cN)(ii)(aa)-(dd) of the Act.

1.7 Scope and demarcation

The scope and demarcation of this study will analyse income tax only, and it will exclude the study of any other tax types. This study will also exclude the analyses of the tax administration of Public Benefit Organisations.

1.8 Outline of dissertation

Chapter one: Introduction

The first chapter provides some background on the development of tax legislation as it pertains to South African Public Benefit Organisations. It furthermore outlines the issues that will be elaborated on in the subsequent chapters.

Chapter two: Public Benefit Organisations in South Africa

The second chapter provides for a detailed discussion on the requirements and conditions contained in Section 30 of the Act that provides for the approval of organisations as Public Benefit Organisations. The chapter furthermore describes the requirements and conditions in terms of Section 10(1)(cN) of the Act that allows Public Benefit Organisations to enjoy preferential tax treatment.

Chapter three: Charities in England and Wales

The third chapter outlines the main conditions and requirements of registering a charity in England and Wales, the Charities Commission's powers and functions and a specific emphasis on a charity's scope contained in the Income Tax Act and the Charities Act to participate in "business undertakings" or "trading activities".

Chapter four: Similarities and Differences

The fourth chapter provides a detailed analyses of the similarities and differences of the legal conditions and requirements of Public Benefit Organisations in South Africa compared to charities in England and Wales. It will furthermore critically discuss the scope of such organisations to participate in a "business undertaking" and "trading activity" under the Income Tax Act in both countries. Highlighting the lessons that could be learned may encourage the tax legislation in South Africa to be further developed in a manner that it continues to contribute by allowing the South African government to provide a supportive environment to such organisations.

Chapter five: Conclusion

The closing chapter of this research sums up of the detailed discussions, highlighting the most important lessons from the information contained in this research study. This chapter will draw the research to a conclusion.

CHAPTER 2

PUBLIC BENEFIT ORGANISATIONS IN SOUTH AFRICA

2.1 Introduction

The scale of philanthropy⁸⁵ in South Africa is significant.⁸⁶ Philanthropy is vital to complement the government's responsibility of creating and enabling an environment for social and developmental activities to help in addressing the needs of the population. The Davis Tax Committee (DTC)⁸⁷ wrote in its March 2018 report that an estimated R22 billion is donated each year by approximately 35 million South Africans who are above the age of 18 years.⁸⁸ The value of the non-profit sector is approximately R60 billion.⁸⁹

It is important to critically analyse the relevant sections of the Income Tax Act 58 of 1962 (the Act) in attempting to understand how the South African tax system impacts on the capacity of approved Public Benefit Organisations (PBOs) to help address the socio-economic challenges in the attenuation of financial support. The Court confirmed in *XY Mining v The Commissioner for the South African Revenue Service* that only approved PBOs must enjoy preferential tax because they help the government to address the socio-economic challenges.⁹⁰

Detailed discussions follow hereinafter of the meaning, requirements, and conditions of a PBO. The preferential tax treatment of PBOs⁹¹ and their ability to undertake business or trading activities are discussed further in this chapter. It furthermore looks at profit share accrual of a PBO in increasing its finances to support the implementation of its activities and growing needs.

⁸⁵ Philanthropy is generally defined to exclude subsidies received from the government.

⁸⁶ In the 2015/2016 State of South African Registered Non-profit Organisations issued in terms of the Nonprofit Organisations Act 71 of 1997 it was reported that registered Nonprofit Organisations had grown in that financial year by 12.6% from 136 453 to 153 677 by the end of March 2016.

⁸⁷ Davis Tax Committee: Public Benefit Organisations Report: March 2018 1.

⁸⁸ Davis Tax Committee: Public Benefit Organisations Report: March 2018 1.

⁸⁹ Davis Tax Committee: Public Benefit Organisations Report: March 2018 1.

⁹⁰ *XY Mining v The Commissioner for the South African Revenue Service* ITC 25390 (2021) ZATC (18 May 2021) 2.

⁹¹ Section 10(1)(cN) of the Act.

2.2 The meaning of a Public Benefit Organisation in South Africa

Section 30(1) of the Act defines a Public Benefit Organisation (PBO) as

any organisation which is (i) a non-profit company; or (ii) a trust; or (iii) an association of persons that has been incorporated, formed or established in the Republic of South Africa; or (iv) any branch within the Republic of South Africa of any company, association or trust incorporated, formed or established in any other country than the Republic of South Africa that is exempt from income tax in that country.⁹²

The PBO's income determines its number of beneficiaries, the duration of its services and the total geographical areas in which it can operate. The more income a PBO receives, the more significant the number of beneficiaries who access its services on a broader scale and for a more extended period. This type of funding model was sufficient in South Africa post-1994.

The media coverage that highlighted the gross human rights violations against and poverty of non-white South Africans, caused the international donor community to make large multi-year donations to organisations that worked to fight against such injustices. This pro-South Africa attitude from international donors led to a false sense of financial security in the South African non-profit sector.⁹³ The sense of financial security given by international donors to the non-profit sector in South Africa shifted during the early parts of the year 2000.

It is imperative to mention that the more nonprofit organisations (NPOs) struggle to survive financially, the less likely they are able render much-needed services to the South African poor and disadvantaged people. In 2000, the government included in the Income Tax Act that approved PBOs can enjoy preferential tax treatment when undertaking business or trading activities and have more income available to render services to the poor and disadvantaged people in South Africa.⁹⁴

⁹² Section 30(1)(a)(i)-(ii) of the Act.

⁹³ Davis [2013 Archive - The great NGO funding crisis, Part III: Adapt or die \(ru.ac.za\)](#) (Date of use: 6 November 2022).

⁹⁴ Section 10(1)(cN) and section 30 of the Act.

2.3 Requirements for approval as a PBO

Organisations that provide services on a not-for-profit basis do not enjoy automatic preferential treatment.⁹⁵ An organisation must apply to the Commissioner for the South African Revenue Service (SARS) and submit its applications to the Tax Exemption Unit (TEU) of SARS. This unit will approve the organisation as a PBO once all requirements are met, in terms of section 30 read together with the Ninth Schedule to the Act. An approved PBO enjoys preferential tax treatment of some receipts and accruals. The PBO will be exempt to pay ordinary tax,⁹⁶ on its gross income,⁹⁷ during any year or period of assessment, as required by the Act.

A PBO's principal or sole objective must be to carry out one or more public benefit activity.⁹⁸ The public benefit activity must be implemented in a non-profit manner and with benevolent intent.⁹⁹ The promotion of "economic self-interest of any fiduciary or employee of the organisation", other "than by way of reasonable remuneration payable to" a "fiduciary or employee" must never be the direct or indirect aim of any public benefit activity.¹⁰⁰ The activity implemented by the applicant organisation must be "for the benefit of, or" it must be broadly "accessible to, the general public at large, including any sector thereof other than small and exclusive groups".¹⁰¹

The Commissioner for SARS approves organisations as PBOs as prescribed and regulated by the Minister of Finance.¹⁰² A copy of the organisation's written constitution or written document that describes its establishment must be submitted

⁹⁵ <https://www.sars.gov.za/businesses-and-employers/tax-exempt-institutions/> (Date of use: 12 November 2022).

⁹⁶ "Normal Tax" is defined in section 1 of the Act, to mean "the income tax referred to in section 5(1) of the Act".

⁹⁷ The term "gross income for the purposes of income tax" is defined in section 1 of the Act as ...in relation to any year or period of assessment, means in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident during such year or period of assessment, excluding receipts or accruals of a capital nature... .

⁹⁸ Section 30(1) of the Act defines "public benefit activity" as any activity listed in Part I of the Ninth Schedule and any other activity determined by the Minister from time to time by notice in the Government Gazette to be of a benevolent nature, having regards to the needs, interests and well-being of the general public.

⁹⁹ Section 30(1)(b)(i) of the Act.

¹⁰⁰ Section 30(1)(b)(ii) of the Act.

¹⁰¹ Section 30(1)(c)(i) of the Act.

¹⁰² Section 30(3)(a) of the Act.

to the Commissioner for SARS.¹⁰³ These written documents must clearly state that the organisation has a minimum of three unconnected persons in relation to each other,¹⁰⁴ who assume the fiduciary responsibility of the PBO.¹⁰⁵

The PBO must appoint a minimum of three unconnected persons to control such an organisation's decision-making, which prevents a single person's domination.¹⁰⁶ The only exception to the abovementioned is in terms of organisations established as a testamentary trust, which is any trust that is in terms of a will of any person for the benefit of the beneficiaries in the written instrument, called the trust deed.¹⁰⁷ The Commissioner for SARS must be satisfied that the constitution, will or other written instrument of the PBO prevents any fiduciary person from direct or indirect financial benefit except when such a person undertakes a public benefit activity.¹⁰⁸ The constitution, will or other written instrument must state that the funds of the organisation will only be used for the object for which the organisation was established before the Commissioner for SARS will approve the said organisation as a PBO.¹⁰⁹

An organisation seeking successful approval as a PBO must disclose in its constitution, will or any other written instrument that it submits the Commissioner for SARS that, upon termination, its assets will be handed over to any approved PBO¹¹⁰ or to any institution, board or body that enjoys preferential tax treatment¹¹¹ or to any sphere of the South African government¹¹² or to the National Finance Housing Corporation¹¹³.¹¹⁴ In addition to the type of entities contained in section 30(3)(b)(iii) of the Income Tax Act 58 of 1962 that qualifies to receive the assets of the closing PBO, the constitution, will or written instrument must also mention that the said entities must only use the transferred assets to “carry on one or more public benefit

¹⁰³ Section 30(3)(b) of the Act.

¹⁰⁴ The term “connected persons” is defined in section 1 of the Act.

¹⁰⁵ Section 30(3)(b)(i) of the Act.

¹⁰⁶ Section 30(3)(b) of the Act.

¹⁰⁷ Section 30(3)(b)(i) of the Act.

¹⁰⁸ Section 30(3)(b)(ii) of the Act.

¹⁰⁹ Section 30(3)(b)(ii) of the Act.

¹¹⁰ Section 30(3)(iii)(aa) of the Act.

¹¹¹ Section 10(1)(cA(i) of the Act.

¹¹² Section 10(1)(a) of the Act.

¹¹³ Section 10(1)(t)(xvii) of the Act.

¹¹⁴ Section 30(3)(b)(iii) of the Act.

activities”.¹¹⁵ Another requirement that must be contained in the constitution, will or other written instrument of a PBO A foreign PBO with a South African branch¹¹⁶ that collects 15 percent and more receipts and accruals over a period of three years prior to its termination from its South African branch, must upon termination transfer all its assets to any one of the PBO, “institution”, “board”, “body”, “department” or “administration” mentioned in section 30(3)(b)(iii) of the Income Tax Act 58 of 1962.¹¹⁷ The rest of section 30(3) explains in detail the steps that the Commissioner may take to ensure adequate compliance and action when PBOs fail to comply with the sections of the Act.

The Court discussed in *AB Trust v Commissioner for the South African Revenue Service* how the abovementioned legal requirements would be applied when an organisation seeks approval as a PBO in terms of section 30 of the Income Tax Act 58 of 1962.¹¹⁸ The nature of the dispute in the said case was if the Appellant, AB Trust, met the legal requirements in section 30, read together with the Ninth Schedule to the Income Tax Act 58 of 1962 to qualify as a PBO.¹¹⁹ The Court confirmed that the first of three main legal requirements for approval as a PBO is that the organisation must be defined as one of the definitions of a public benefit organisation that is contained in section 30(1) of the Income Tax Act 58 of 1962.¹²⁰ The second legal requirement is the “sole or principal objective” of the organisation must be one of the listed “public benefit activities” contained in the Ninth Schedule to the Income Tax Act 58 of 1962.¹²¹ The third legal requirement is that organisation “must comply with the formal requirements set out in section 30(3) of the Income Tax Act”.¹²²

¹¹⁵ Section 30(3)(b)(iii) of the Act.

¹¹⁶ Paragraph (a) (ii) of the definition of “public benefit organization” in Section 30(1) of the Act.

¹¹⁷ Section 30(3)(b)(iiiA) of the Act.

¹¹⁸ *AB Trust v The Commissioner for the South African Revenue Service* ITC 13254 (2014) ZATC (22 January 2014).

¹¹⁹ Paragraph 6 of *AB Trust v The Commissioner for the South African Revenue Service* ITC 13254 (2014) ZATC (22 January 2014).

¹²⁰ Paragraph 7 of *AB Trust v The Commissioner for the South African Revenue Service* ITC 13254 (2014) ZATC (22 January 2014).

¹²¹ Paragraph 7 of *AB Trust v The Commissioner for the South African Revenue Service* ITC 13254 (2014) ZATC (22 January 2014).

¹²² Paragraph 7 of *AB Trust v The Commissioner for the South African Revenue Service* ITC 13254 (2014) ZATC (22 January 2014).

The Appellant applied to the Commissioner for SARS for approval as a PBO, but the application was unsuccessful. The Commissioner for SARS stated that the activities of the Appellant were not “accessible to the general public” or “to benefit the poor and needy people”, which is required by section 30 of the Income Tax Act 58 of 1962.¹²³ Accordingly, the organisation’s activities did not meet the legal requirements contained in section 30 of the Income Tax Act 58 of 1962.¹²⁴ The Appellant disagreed with the Commissioner for SARS and after several attempts to appeal against the decision of its unsuccessful application, it approached the Tax Court to assess whether the objectives of the organisation meets the requirements that are set out in section 30 of the Income Tax Act 58 of 1962.¹²⁵

The Court had to assess if the Commissioner for SARS may refuse the Appellant’s said application because the organisation has not yet commenced implementing its activities.¹²⁶ The second issue was if the Commissioner for SARS was obliged to approve the Appellant’s application as a PBO because its founding documents met the legal requirements of section 30 of the Income Tax Act 58 of 1962.¹²⁷ Finally, the Court was requested to assess if the activities of the Appellant met the requirements “of one or more of the activities listed in the Ninth Schedule to the Income Tax Act 58 of 1962”.¹²⁸

The Court agreed that the Commissioner for SARS must firmly examine the applications for approval as a PBO.¹²⁹ However, the Court said that the Commissioner for SARS must consider a more comprehensive view when assessing if the activities of the applicant organisation meet the legal requirements

¹²³ Paragraph 18 of *AB Trust v The Commissioner for the South African Revenue Service* ITC 13254 (2014) ZATC 26 (22 January 2014).

¹²⁴ Paragraph 17 of *AB Trust v The Commissioner for the South African Revenue Service* ITC 13254 (2014) ZATC 26 (22 January 2014).

¹²⁵ Paragraph 21 of *AB Trust v The Commissioner for the South African Revenue Service* ITC 13254 (2014) ZATC 26 (22 January 2014).

¹²⁶ Paragraph 26 of *AB Trust v The Commissioner for the South African Revenue Service* ITC 13254 (2014) ZATC 26 (22 January 2014).

¹²⁷ Paragraph 26 of *AB Trust v The Commissioner for the South African Revenue Service* ITC 13254 (2014) ZATC 26 (22 January 2014).

¹²⁸ Paragraph 26 of *AB Trust v The Commissioner for the South African Revenue Service* ITC 13254 (2014) ZATC 26 (22 January 2014).

¹²⁹ Paragraph 41 of *AB Trust v The Commissioner for the South African Revenue Service* ITC 13254 (2014) ZATC 26 (22 January 2014).

of a public benefit activity.¹³⁰ The Court confirmed that the applicant organisation must comply with the legal requirements contained in section 30 of the Income Tax Act 58 of 1962 and that its proposed activity falls within the framework set out in the Ninth Schedule to the Income Tax Act 58 of 1962.¹³¹ The Appellant satisfied the Court that its activities to be undertaken were “benevolent of nature” and that no fiduciary person will receive undue benefit except for reasonable remuneration provided for in section 30 of the Income Tax Act 58 of 1962.¹³² The Court was satisfied that the Commissioner for SARS should have approved the Appellant’s application because it met the legal requirements contained in section 30 of the Income Tax Act 58 of 1962.¹³³ The Court furthermore confirmed that the Appellant’s objectives and daily activities meet the requirements set out in the Ninth Schedule to the Income Tax Act 58 of 1962.¹³⁴

Upon approval as a PBO, the Appellant would be in a position to enjoy preferential tax treatment in terms of section 10(1)(cN) of the Income Tax Act 58 of 1962.¹³⁵ Section 10(1)(cN) of the Income Tax Act 58 of 1962 will be discussed in detail under the next heading.

2.4 Business undertakings and trading activities of PBOs

An organisation that is approved as a PBO in terms of section 30 read together with Part I of the Ninth Schedule to the Income Tax Act 58 of 1962 qualifies for the enjoyment of preferential tax treatment.¹³⁶ An approved PBO enjoys preferential tax treatment in South Africa, in terms of section 10(1)(cN) of the Act.

¹³⁰ Paragraph 41 of *AB Trust v The Commissioner for the South African Revenue Service* ITC 13254 (2014) ZATC 26 (22 January 2014).

¹³¹ Paragraph 41 of *AB Trust v The Commissioner for the South African Revenue Service* ITC 13254 (2014) ZATC 26 (22 January 2014).

¹³² Paragraph 45 of *AB Trust v The Commissioner for the South African Revenue Service* ITC 13254 (2014) ZATC 26 (22 January 2014).

¹³³ Paragraph 45 of *AB Trust v The Commissioner for the South African Revenue Service* ITC 13254 (2014) ZATC 26 (22 January 2014).

¹³⁴ Paragraph 50 of *AB Trust v The Commissioner for the South African Revenue Service* ITC 13254 (2014) ZATC 26 (22 January 2014).

¹³⁵ Paragraph 50 of *AB Trust v The Commissioner for the South African Revenue Service* ITC 13254 (2014) ZATC 26 (22 January 2014).

¹³⁶ Section 30 and Section 10(1)(cN) of the Act.

Section 10(1)(cN) states that:

there shall be exempt from normal tax the receipts and accrual of any public benefit organisation approved by the Commissioner in terms of section 30(3), to the extent that the receipts and accruals are derived –

- (i) otherwise than from any business undertaking or trading activity; or
- (ii) from any business undertaking or trading activity
 - (aa) if the undertaking or activity –
 - (A) is integral and directly related to the sole or principal object of that public benefit organisation as contemplated in paragraph (b) of the definition of “public benefit organisation” in section 30;
 - (B) is carried out or conducted on a basis of substantially the whole of which is directed towards the recovery of cost; and
 - (C) does not result in unfair competition in relation to taxable entities;
 - (bb) if the undertaking or activity is of an occasional nature and undertaken substantially with assistance on a voluntary basis without compensation;
 - (cc) if the undertaking or activity is approved by the Minister by notice in the Gazette, having regard to –
 - (A) the scope and benevolent nature of the undertaking or activity;
 - (B) the direct connection and interrelationship of the undertaking or activity with the sole or principal object of the public benefit organisation;
 - (C) the profitability of the undertaking or activity; and
 - (D) the level of economic distortion that may be caused by the tax-exempt status of the public benefit organisation carrying on the undertaking or activity; or
 - (dd) other than an undertaking or activity in respect of which item (aa), (bb) or (cc) applies and do not exceed the greater of –
 - (i) 5 per cent of the total receipts and accruals of that public benefit organisation during the relevant year of assessment; or
 - (ii) R200 000;¹³⁷

Section 10(1)(cN)(i) provides for the total exemption from paying normal tax if a PBO’s receipts and accruals derive from activities that have no relation to trade or business undertakings.¹³⁸ If a PBO receives receipts and accruals from “business undertakings” or “trading activities”, such income will be assessed against the restrictions contained in section 10(1)(cN)(ii) to determine if the said income will be fully exempted or partially exempted from paying normal tax.¹³⁹ The meaning of partial exemption is that only the receipts and accruals that meet the requirements contained in section 10(1)(cN)(ii) will be exempt from paying normal tax and the receipts and accruals that derive from activities related to business undertakings or

¹³⁷ Section 10(1)(cN) of the Act.

¹³⁸ Section 10(1)(cN)(i) of the Act.

¹³⁹ Section 10(1)(cN)(ii) of the Act.

trading activities will be charged with a normal tax levy.¹⁴⁰ It will therefore be wrong to assume that all PBO activities enjoy complete exemption from paying a tax levy. It is also wrong to assume that the total receipts and accruals in any year of assessment is exempted from being charged with paying a tax levy.¹⁴¹ In the absence of the approval as a PBO and preferential tax treatment in terms of section 10(1)(cN),¹⁴² SARS will impose a standard income tax charge on the PBO.

Section 10(1)(cN)(ii) limits the total amount of income that is generated during a year of assessment from a “business undertaking” or “trading activity”. A PBO’s receipts and accruals that derive from any business undertaking or trading activity will enjoy preferential tax treatment, if such activities fall within one of four categories¹⁴³ that are contained in section 10(1)(cN) of the Act.

The first part of the first category states that a “business undertaking” or “trading activity” must be “integral and directly related to the sole or principal object” of the PBO.¹⁴⁴ SARS explains that although there is no definition of the term “business” in the Income Tax Act 58 of 1962, it is acceptable to include “anything occupying the time, attention and labours of a person for profit”.¹⁴⁵ When assessing if an activity is a “business undertaking” factors like “intention”, “motive”, “frequency” and “nature of the activity” must be considered.¹⁴⁶ SARS explained that if a money lender “advances interest from interest-bearing loans at market-related rates”, such an activity will be interpreted as a “business undertaking” and would therefore be charged with a normal tax levy.¹⁴⁷ However if the PBO “passively invests any of its surplus funds in shares or invests some funds in a financial institution, such an activity will not be seen as a “business undertaking” or “trading activity”.¹⁴⁸

Section 10(1)(cN)(ii)(bb)(A) of the Income Tax Act 58 of 1962 requires that the “business undertaking” or “trading activity” must be “integral and directly related to

¹⁴⁰ Section 10(1)(cN) of the Act.

¹⁴¹ Section 10(1)(cN) of the Act.

¹⁴² Section 10(1)(cN) of the Act.

¹⁴³ Section 10(1)(cN)(ii)(aa) – (dd) of the Act.

¹⁴⁴ Section 10(1)(cN)(ii)(aa)(A) of the Act.

¹⁴⁵ SARS Interpretation Note 24 Issue 2 12 February 2018 4.

¹⁴⁶ SARS Interpretation Note 24 Issue 2 12 February 2018 4.

¹⁴⁷ SARS Interpretation Note 24 Issue 12 February 2018 4.

¹⁴⁸ SARS Interpretation Note 24 Issue 12 February 2018 4.

the sole or principal object” of the PBO.¹⁴⁹ SARS explained this term to mean that the “business undertaking” or “trading activity” must be an integral part of and it must be directly linked to carrying on the PBO’s public benefit activities.¹⁵⁰ SARS gives the example of a PBO that provides healthcare services to poor and needy people but charges for medication from the medical consultation services. The income earned from the sale of medication will not be charged with a normal tax levy if it is used to continue the provision of healthcare services to the poor and needy people, which is its core objective of the PBO.¹⁵¹ In the Interpretation Note 24, SARS explains that a PBO cannot have more than one “sole or principal object”, but the organisation can implement more than one “public benefit activity”.¹⁵² Section 10(1)(cN)(ii)(A) of the Income Tax Act 58 of 1962 implies that for a “business undertaking” or “trading activity” to be exempt from paying the normal income tax levy, the PBO must prove that the said activity relates directly and integrally to the “sole or principal object” of the organisation.¹⁵³ If a PBO cannot prove this, the income that derived from such an activity will be charged with a normal tax levy because it will be regarded as a “business undertaking” or “trading activity”.¹⁵⁴

Section 10(1)(cN)(ii)(B) states that the “business undertaking” or “trading activity” must also be “carried out or conducted on a basis of substantially the whole of which is directed towards the recovery of costs”.¹⁵⁵ The intention of the “business undertaking” or “trading activity” must not be to “maximise profit”.¹⁵⁶ SARS explains the term “recovery of costs” mean that the intention of the “business undertaking” or “trading activity” must be to recover “direct and reasonable indirect costs” of the PBO.¹⁵⁷

The second part of the first category requires the business undertaking or trading activity that the PBO conducts to be “substantially the whole” aimed at the

¹⁴⁹ Section 10(1)(cN)(ii)(aa)(A) of the Act.

¹⁵⁰ SARS Interpretation Note 24 Issue 2 12 February 2018 4.

¹⁵¹ SARS Interpretation Note 24 Issue 2 12 February 2018 4.

¹⁵² SARS Interpretation Note 24 Issue 2 12 February 2018 5.

¹⁵³ SARS Interpretation Note 24 Issue 2 12 February 2018 5.

¹⁵⁴ Section 10(1)(cN)(ii)(A) of the Act.

¹⁵⁵ Section 10(1)(cN)(ii)(B) of the Act.

¹⁵⁶ SARS Interpretation Note 24 Issue 2 12 February 2018 5.

¹⁵⁷ SARS Interpretation Note 24 Issue 2 12 February 2018 5.

recuperation of cost.¹⁵⁸ The words “substantially the whole” were interpreted in Binding General Ruling 20 to mean strictly 90% or more, but because PBOs function in uncertain environment, SARS will accept a percentage of a minimum of 85%.¹⁵⁹ It is essential for the intention of the trading activity or business undertaking to be the recuperation of direct or indirect cost incurred and not to make a profit.¹⁶⁰

Lastly, the third part of the first category of requirements is that the trading activity or business undertaking performed by a PBO may not result in unfair competition with other taxable entities.¹⁶¹ The court has to date not been asked to interpret “unfair competition” in terms of the Act.

The second category that will qualify a PBO to enjoy preferential treatment when conducting a business undertaking or trading activity is

if the undertaking or activity is of an occasional nature and undertaken substantially with assistance on a voluntary basis without compensation.¹⁶²

Section 1 of the Act that defines “trade” to include

every profession, trade, business, employment, calling, occupation or venture, letting of any property and the use of or the grant of permission to use any patent as defined by the Patents Act or any design as defined in the Designs Act or any trade mark as defined in the Trade Marks Act or any copyright as defined in the Copyright Act or any other property which is of a similar nature.¹⁶³

SARS explains that when interpreting the term “trade”, the Courts will consider any activity that has the potential of making profit.¹⁶⁴ It furthermore emphasise that the merits of each case must be considered when determining if an activity runs the risks of qualifying as “trade”.¹⁶⁵ Section 10(1)(cN)(ii)(bb) states that if a PBO wants its “business undertaking” or “trading activity” to be exempted from paying a normal tax levy, it must proof that the “undertaking or activity is of an occasional nature and

¹⁵⁸ Section 10(1)(cN)(ii)(aa)(B) of the Act.

¹⁵⁹ Binding General Ruling 20 Issue 3 dated 13 November 2018 Interpretation of the Expression Substantially the Whole 5.

¹⁶⁰ SARS Interpretation Note 24 Issue 4 12 February 2018 5.

¹⁶¹ Section 10(1)(cN)(ii)(aa)(C) of the Act.

¹⁶² Section 10(1)(cN)(ii)(bb) of the Act.

¹⁶³ Section 1(1) of the Act, as amended defines “trade” and includes every profession, trade, business, employment, calling, occupation or venture, letting of property and the use of or the grant of permission to use a patent, design, trademark or copyright.

¹⁶⁴ SARS Interpretation Note 24 Issue 4 24 February 2018 7.

¹⁶⁵ SARS Interpretation Note 24 Issue 4 24 February 2018 7.

undertaken substantially with assistance on a voluntary basis without compensation”.¹⁶⁶ SARS explains that the said terms mean that the “business undertaking” or “trading activity” must not take place habitually or repeatedly.¹⁶⁷ If the “business undertaking” or “trading activity” takes place during a special occasion, the income from the undertaking or activity will be exempt from paying a normal tax levy in terms of section 10(1)(cN)(ii)(bb).¹⁶⁸ SARS illustrate the meaning of the term “an occasional nature” with examples of raising funds at a gala dinner or volunteers selling Christmas cards.¹⁶⁹

The third category that will qualify a PBO to enjoy preferential tax treatment when conducting a business undertaking or trading activity is when the Minister of Finance approves the said undertaking or activity “by notice in the Gazette”.¹⁷⁰ Section 10(1)(cN)(ii)(cc) describes four factors that the Minister of Finance must consider when approving any business undertaking or trading activity of a PBO to be exempted from paying a normal tax levy.¹⁷¹ The first factor that the Minister of Finance considers is if the “nature and scope” of the business undertaking or trading activity of the PBO can be regarded as benevolent.¹⁷² Section 10(1)(cN)(ii)(cc)(A) confirms that the Minister of Finance will only approve a business undertaking or trading activity conducted by a PBO as tax exempted if the intention of the said activity is benevolent of nature and of scope and not to make a profit.¹⁷³ The second factor is “the direct connection and interrelationship of the undertaking or activity with the sole or principal object of the PBO.”¹⁷⁴ Section 10(1)(cN)(ii)(cc)(B) means that there must be a direct link and a relationship between the PBO’s business undertaking or trading activity and the “sole or principal object” of the organisation before the Minister of Finance will approve the undertaking or activity to enjoy tax exemption.¹⁷⁵ The Minister of Finance must also consider how profitable the business undertaking or trading activity of the PBO is before it will approve such

¹⁶⁶ Section 10(1)(cN)(ii)(bb) of the Act.

¹⁶⁷ SARS Interpretation Note 24 Issue 4 24 February 2018 4.

¹⁶⁸ SARS Interpretation Note 24 Issue 4 24 February 2018 5.

¹⁶⁹ SARS Interpretation Note 24 Issue 4 24 February 2018 5.

¹⁷⁰ Section 10(1)(cN)(ii)(cc) of the Act.

¹⁷¹ Section 10(1)(cN)(ii)(cc) of the Act.

¹⁷² Section 10(1)(cN)(ii)(cc)(A) of the Act.

¹⁷³ Section 10(1)(cN)(ii)(cc)(A) of the Act.

¹⁷⁴ Section 10(1)(cN)(ii)(cc)(B) of the Act.

¹⁷⁵ Section 10(1)(cN)(ii)(cc)(B) of the Act.

undertaking or activity to enjoy tax exemption.¹⁷⁶ Lastly, the Minister of Finance must give regard to the “level of economic distortion that may be caused by the tax-exempt status of the public benefit organisation carrying on the undertaking or activity”.¹⁷⁷ SARS explains this category to mean that the said submission must prove its benefit to the general public, state reasons why such approval will not result in unfair competition with other taxable entities and that it will not grind down the tax base.¹⁷⁸ No application of this nature has been referred to the Minister of Finance in South Africa to date.

Finally, the general rule is that where a business undertaking or trading activity of a PBO does not fall within any one of the three categories mentioned above, section 10(1)(cN)(ii)(dd) applies to such undertaking or activity, meaning that such undertaking or activity will be subject to a basic tax exemption.¹⁷⁹ The basic tax exemption of the business undertaking or trading activity is “5 percent of the total receipts and accruals during the relevant year of assessment” or R200 000, whichever is more.¹⁸⁰ SARS explained the practical application of the basic tax exemption threshold means that PBO must calculate the total receipts and accruals of all the business undertakings or trading activities that fall outside the scope of the exemptions mentioned in section 10(1)(cN)(ii)(aa) - (cc) in the relevant year of assessment.¹⁸¹ Only if a business undertaking or trading activity meets the requirements contained in section 10(1)(cN)(ii) and described in detail above, will such a business undertaking or trading activity enjoy complete tax exemption.¹⁸² If it does not meet the said legal requirements, such a business undertaking or trading activity will be charged with a normal tax levy as determined by the Income Tax Act 58 of 1962.¹⁸³ Only the business undertakings or trading activities that do not fall in the categories mentioned in section 10(1)(cN)(ii)(aa) - (cc) have a restriction of 5 percent of the sum total or R20 000 whichever is greater as discussed earlier in this paragraph.¹⁸⁴ If the business undertaking or trading activity falls within any one of

¹⁷⁶ Section 10(1)(cN)(ii)(cc)(C) of the Act.

¹⁷⁷ Section 10(1)(cN)(ii)(cc)(D) of the Act.

¹⁷⁸ SARS Interpretation Note 24 Issue 4 24 February 2018 10.

¹⁷⁹ Section 10(1)(cN)(ii)(dd) of the Act.

¹⁸⁰ Section 10(1)(cN)(ii)(dd) of the Act.

¹⁸¹ SARS Interpretation Note 24 Issue 4 24 February 2018 11.

¹⁸² SARS Interpretation Note 24 Issue 4 24 February 2018 11.

¹⁸³ Section 10(1)(cN)(ii) of the Act.

¹⁸⁴ Section 10(1)(cN)(ii) of the Act.

the categories mentioned in section 10(1)(cN)(ii)(aa) - (cc) there is no restriction on its total sum receipts and accruals per year of assessment.¹⁸⁵

2.5 PBOs and Capital Gains Tax

Section 10(1)(cN) of the Act does not apply to or include capital gains tax of an approved PBO because a capital gain is not a receipt or accrual.¹⁸⁶ However, Section 26A states, that the taxable capital gain of a person for the year of assessment, will be included in that person's taxable income and that this inclusion will be in terms of the provisions outlined in the Eighth Schedule to the Act.¹⁸⁷

In *Lion Match Company (Pty) Ltd v Commissioner for the South African Revenue Service*,¹⁸⁸ the court confirmed that section 26A of the Act links the Eighth Schedule to the provisions of the main body of the Act.¹⁸⁹ A PBO can qualify for preferential tax treatment on capital gain tax in terms of any capital gain,¹⁹⁰ or any capital loss,¹⁹¹ if the PBO satisfies the requirements as outlined in paragraph 63A of the Eighth Schedule to the Act, as amended.

The first requirement is that an approved PBO must "not use the asset on or after the valuation date in carrying on any business undertaking or trading activity".¹⁹² The second requirement is that "substantially the whole of the use of that asset by the public benefit organisation on and after valuation date was directed at a purpose other than carrying on a business undertaking or trading activity" or that "carrying on a business undertaking or trading activity contemplated in section 10(1)(cN)(ii)(aa), (bb) or (cc)".¹⁹³ If this is indeed the case the business task or

¹⁸⁵ Section 10(1)(cN)(ii) of the Act.

¹⁸⁶ Haupt *Notes on South African Income Tax* 17.

¹⁸⁷ Section 26A of the Act.

¹⁸⁸ *Lion Match Company (Pty) Ltd v Commissioner for the South African Revenue Service* 80 SACT 383 (SCA) 385.

¹⁸⁹ Section 26A and the Eighth Schedule to the Act were introduced by the Taxation Laws Amendment Act 5 of 2001.

¹⁹⁰ Capital gain means "the amount determined in terms of paragraph 3 of the Eighth Schedule to the Income Tax Act 58 of 1962".

¹⁹¹ Capital loss means "the amount determined in terms of paragraph 4 of the Eighth Schedule to the Income Tax Act 58 of 1962".

¹⁹² Paragraph 63A(a) of the Eighth Schedule to the Act.

¹⁹³ Paragraph 63A(b) of the Eighth Schedule to the Act.

trading action must take place within the requirements set out in section 10(1)(cN)(ii)(aa), (bb) or (cc) of the Act.¹⁹⁴

SARS explains that a PBO will not be charged with a capital gain or capital loss tax levy “on the disposal of three categories of assets”.¹⁹⁵ When a PBO disposes of an “non-trading assets” meaning assets that “ have not been used by the PBO on or after valuation date in carrying on any business undertaking or trading activity” it is excluded from the calculation of capital gain or capital loss tax levy.¹⁹⁶ An example to explain this category of assets is when assets are “exclusively used on or after the valuation date” to implement public benefit activities, it will be excluded from paying a capital gain or capital loss tax levy.¹⁹⁷ A PBO will not be liable to pay a capital gain or capital loss tax levy if the PBO disposes of an asset that it merely “held” and did not “use” for a “business undertaking” or “trading activity”.¹⁹⁸ The second category deals with a situation when a PBO disposes of an asset that is used for a business undertaking or trading activity. Paragraph 63A(b)(i) of the Eighth Schedule to the Act means that a PBO who disposes of an asset that is used “substantially the whole” on or after the valuation date to implement a public benefit activity such an asset will be excluded from paying a capital gain or capital loss tax levy.¹⁹⁹ When explaining the meaning of the term “substantially the whole” SARS regards the said term to mean “90% or more”, but according to Binding General Rule 20, it will accept the asset to be used with a “percentage of not less than 85%”.²⁰⁰ Category one and category must not be confused. The first category deals with a situation when the PBO disposes of an asset that is “held” and “used” and the second category deals with a situation where the asset that the PBO disposes of is in fact used. The third and final category deals with a PBO that disposes of an asset where the business undertaking or trading activity is permissible under section 10(1)(cN)(ii) of the Act.²⁰¹ Where a business undertaking or trading activity qualifies for an exemption from paying an income tax levy in terms of any of the categories

¹⁹⁴ Paragraph 63A(b) of the Eighth Schedule to the Act.

¹⁹⁵ SARS Interpretation Note 44 Issue 3 21 February 2020 7.

¹⁹⁶ SARS Interpretation Note 44 Issue 3 21 February 2020 7.

¹⁹⁷ SARS Interpretation Note 44 Issue 3 21 February 2020 7.

¹⁹⁸ SARS Interpretation Note 44 Issue 3 21 February 2020 7.

¹⁹⁹ Paragraph 63A(b)(i) of the Eighth Schedule to the Act.

²⁰⁰ Binding General Ruling 20 Issue 3 dated 13 November 2018 Interpretation of the Expression Substantially the Whole 5.

²⁰¹ Paragraph 63A(b)(ii) of the Eighth Schedule of the Act.

mentioned in “items (aa), (bb) or (cc) of section 10(1)(cN)(ii) of the Act, the said asset will also enjoy an exemption from a charge of capital gain or capital loss when a PBO disposes of it.²⁰² It must be noted that when an asset that is used in a business undertaking or trading activity does not fall within the items (aa), (bb) or (cc) of section 10(1)(cN)(ii) of the Act, such an asset will be charged with a capital gain or capital loss tax levy when a PBO disposes of it.²⁰³ The exemption from a capital gain or a capital loss when a PBO disposes of an asset can therefore be divided into the categories when an asset is merely “held” or “not used” in carrying on a business undertaking or trading activity and where an asset is used for carrying on a business undertaking or trading activity. Depending on the circumstances, SARS will disregard the disposal of an asset from liability for capital gains tax on the proceeds of a capital gain or a capital loss in any year of assessment.²⁰⁴

In Binding Private Rule 324, the Commissioner for SARS provided clarity on how different sections and paragraphs of the Act, which included sections 10(1)(cN), 30 and paragraph 63A of the Eighth Schedule to the Act as discussed above, would be interpreted and applied when the applicant PBO disposes of an asset.²⁰⁵ In this specific transaction, applicant was an approved as a PBO in terms of section 30(3) of the Act.²⁰⁶ The said PBO held ordinary shares in a listed company and it was a beneficiary of four trusts that would be dissolved.²⁰⁷ The PBO requested the Commissioner for SARS to clarify if the income from the dissolution of the four trusts and its listed ordinary shares to purchase BEE shares that “trade at a discounted price and yield higher dividends” would constitute a charge on paying a capital gains tax levy.²⁰⁸ The Commissioner for SARS ruled that paragraph 63A of the Eighth Schedule to the Act would apply in respect of the disposal of the ordinary listed shares and the use its earnings to purchase BEE shares “from time to time”

²⁰² Paragraph 63A(b)(ii) of the Eighth Schedule to the Act.

²⁰³ SARS Interpretation Note 44 Issue 3 21 February 2020 9.

²⁰⁴ Paragraph 63A of the Eighth Schedule to the Act.

²⁰⁵ Binding Private Ruling 324 dated 20 August 2019 “Disposal and acquisition of shares by a public benefit organisation” 1.

²⁰⁶ Binding Private Ruling 324 dated 20 August 2019 “Disposal and acquisition of shares by a public benefit organisation” 2.

²⁰⁷ Binding Private Ruling 324 dated 20 August 2019 “Disposal and acquisition of shares by a public benefit organisation” 2.

²⁰⁸ Binding Private Ruling 324 dated 20 August 2019 “Disposal and acquisition of shares by a public benefit organisation” 2.

because the act does not constitute a “business undertaking” or “trading activity”.²⁰⁹ The Commissioner also ruled that the disposal of the said assets would not cause the PBO to lose its approved status in terms of section 30(3) of the Act.²¹⁰ The income that the PBO received from the dividends from its ordinary listed shares held in company A and its income that derived from the interests received in the trusts would be exempted from paying an income tax levy because section 10(1)(cN) would apply in both instances.²¹¹ The Commissioner for SARS ruled that no capital gains tax levy must be charged when the trusts dissolve and pay capital income to the PBO because paragraph 63A of the Eighth Schedule of the Act is applicable.²¹²

The above demonstrates how the Commissioner for SARS interpreted and applied sections 10(1)(cN), 30 and paragraph 63A of the Eighth Schedule to the Act to a specific case. Although the ruling only applies between the applicant and SARS, it illustrates how the Commissioner interprets and applies the relevant sections and paragraphs of the Act in respect of a PBO and capital gains tax.

2.6 Section 18A approval of PBOs

An approved PBO may issue tax-deductible certificates to its donors if SARS approved the PBO after having fulfilled all the prescribed requirements outlined in section 18A of the Act. A taxpayer may deduct a limited amount of the taxable income in terms of the donation. Such deduction is only possible when a taxpayer makes a *bona fide* donation, in cash or in kind, to an approved section 18A PBO. The requirements are that the PBO must implement a public benefit activity in terms of Part II of the Ninth Schedule to the Act and it must satisfy the prescribed requirements outlined Section 18A of the Act.²¹³

²⁰⁹ Binding Private Ruling 324 dated 20 August 2019 “Disposal and acquisition of shares by a public benefit organisation” 2.

²¹⁰ Binding Private Ruling 324 dated 20 August 2019 “Disposal and acquisition of shares by a public benefit organisation” 2.

²¹¹ Binding Private Ruling 324 dated 20 August 2019 “Disposal and acquisition of shares by a public benefit organisation” 2-3.

²¹² Binding Private Ruling 324 dated 20 August 2019 “Disposal and acquisition of shares by a public benefit organisation” 3.

²¹³ SARS Tax Exemption Guide for Public Benefit Organisations in South Africa Issue 5 26 January 2017 22.

One of the requirements in terms of section 18A is that an approved PBO may only issue a tax-deductible certificate for a public benefit activity that was implemented in South Africa and not outside the country.²¹⁴ The court interpreted section 18A(1)(a)(aa) of the Act to mean that an approved PBO may only issue a tax-deductible certificate for public benefit activities implemented in South Africa.²¹⁵ In *AB Trust v The Commissioner for the South African Revenue Service*, the court was asked to give direction to the Commissioner for SARS in granting AB Trust the necessary approval to issue tax deductible certificates to its donors in respect of donations made for the implementation of public benefit activities under Part II of the Ninth Schedule to the Act.²¹⁶ The court dismissed AB Trust's argument that section 18A of the Act does not require a public benefit activity to be implemented exclusively in South Africa for it to qualify to issue a tax-deductible certificate in terms of the said section of the Act.²¹⁷

Before a PBO may issue a tax-deductible certificate in terms of section 18A for a donation made to implement a public benefit activity, it must satisfy the Commissioner for SARS that such a public benefit activity falls within one of the categories listed in Part II of the Ninth Schedule to the Act.²¹⁸ The Davis Tax Committee stated in its 2018 March report to the Minister of Finance that one of the challenges PBOs face to achieve approval in terms of section 18A of the Act, is the period from the date of application to approval can be up to six months.²¹⁹ The delayed approval of a PBO to issue a section 18A tax-deductible certificate results in a delay in receipt of funding from donors.²²⁰ The Davis Tax Committee made five proposals to the Minister of Finance aimed at improving the turnaround time of approvals and improve the knowledge and capacity of its employees in the Tax Exemption Unit.²²¹ The Committee argued that service delivery to the non-profit

²¹⁴ Section 18A(1)(a)(aa) of the Act.

²¹⁵ *AB Trust v The Commissioner for the South African Revenue Service* ITC 13254 (2014) ZATC (22 January 2014) 26.

²¹⁶ *AB Trust v The Commissioner for the South African Revenue Service* ITC 13254 (2014) ZATC (22 January 2014).

²¹⁷ *AB Trust v The Commissioner for the South African Revenue Service* ITC 13254 (2014) ZATC (22 January 2014).

²¹⁸ Section 18A(1)(a)(aa) of the Act.

²¹⁹ Davis Tax Committee: Public Benefit Organisations Report March 2018 25.

²²⁰ Davis Tax Committee: Public Benefit Organisations Report March 2018 25.

²²¹ Davis Tax Committee: Public Benefit Organisations Report March 2018 25 – 26.

sector would be more effective if the Minister of Finance favourably considers the recommendations made in its report.²²²

In terms of section 18A approvals, the Committee requested the Minister of Finance to remove the 50% distribution rule of PBOs which limits conduit organisations.²²³ It also requires, in terms of section 18A(2D) of the Act, that such distribution must occur no later than six months after every five years from the date on which the Commissioner for SARS has issued a reference number. All amounts received must be distributed in terms of the investment assets held.²²⁴

2.7 PBOs and tax implications of income, receipts and accrual

An approved PBO is exempt from paying donations tax when donating to or receiving a gift from a donor.²²⁵

The Minister of Finance replaced what was previously known as Secondary Tax on Companies (STC)²²⁶ with dividends tax²²⁷ on 1 April 2012. Dividends tax is a tax levy payable on income that derives from the dividends declared by a company.²²⁸ Section 64D to section 64N of the Act contains the provisions concerning this specific form of levy, that applies to any dividend²²⁹ that is paid by a company on or after 1 April 2012. Section 64F(1)(c) of the Act makes provision for preferential tax

²²² Davis Tax Committee: Public Benefit Organisations Report March 2018 26.

²²³ Davis Tax Committee: Public Benefit Organisations Report March 2018 26.

²²⁴ Davis Tax Committee: Public Benefit Organisations Report March 2018 26.

²²⁵ Section 56(1)(h) of the Act.

²²⁶ Secondary Tax on Companies (STC) is a levy imposed on companies if and when it declares its dividends.

²²⁷ Dividends Tax is a tax levy imposed on shareholders when they receive dividends from a company. This form of tax is a withholding tax because the company declaring the dividend or a regulated intermediary, and not the shareholder receiving the dividend, is responsible for paying to SARS the current prescribed levy of 15% if the dividend was paid or payable before 22 February 2017 and 20% if the dividend was paid or became payable after 22 February 2019.

²²⁸ Section 1 of the Act.

²²⁹ "Dividend" is defined in section 1(1) of the Act as

any amount, other than the dividend consisting of a distribution of an asset in specie declared and paid as contemplated in section 31(3), transferred or applied by a company that is resident for the benefit or on behalf of any person in respect of any share in that company, whether that amount is transferred or applied (a) by way of a distribution made; or (b) as a consideration for the acquisition of any share in that company, but does not include any amount so transferred or applied- (i) results in the reduction of contributable tax capital of the company; (ii) constitutes shares in the company; or (iii) constitutes an acquisition by the company of its own securities by way of general repurchase of securities as contemplated in subparagraph (b) of paragraph 5.67(B) of section 5 of the JSE Limited Listings Requirements.

treatment when a dividend does not compromise a distribution of an asset *in specie* if the beneficial owner²³⁰ is an approved PBO in terms of section 30(3) of the Act.

In Binding Private Ruling 324 published on 20 August 2019, an approved PBO held ordinary shares in a listed company from which the PBO received dividends which the PBO used to make donations to other approved PBOs. The intention of the applicant PBO was to replace the shares that it held in the listed company with BEE shares²³¹ which would allow the applicant PBO to trade at a discounted price and yield higher dividends in comparison with ordinary shares. The ruling was discussed in detail above.

The employer may subtract an amount equal to the value of 1% from the sum total of the monthly salary from the employee's monthly remuneration.²³² PBOs in South Africa do not enjoy any tax exemption or tax preferential tax treatment in respect of employees' tax or UIF and should take the implications of these two tax types into consideration.

2.8 Conclusion

Organisations working in the philanthropy or benevolent sector can enjoy several preferential tax treatments in South Africa after the Commissioner for SARS approves it as a PBO. The enjoyment of preferential tax treatment is not automatic for not-for-profit organisations or registered NPOs. NPOs must seek approval in terms of the conditions and requirements as set out by section 30 and section 10(1)(cN) of the Act respectively. Section 10(1)(cN)(ii)(aa) - (dd) sets out four criteria with which PBOs must comply should they implement a "business undertaking" or "trading activity". Section 10(1)(cN) of the Act does not include capital gains tax, because a "capital gain" or a "capital loss" is not regarded as a receipt or an accrual. However, section 26A states that it should be considered when determining tax that is due in terms of the Income Tax Act.

²³⁰ The term "beneficial owner" is defined by section 64D of the Act as "the person who is entitled to receive the benefit that is attached to owning a share or shares".

²³¹ In Binding Private Ruling 324 dated 20 August 2019 Disposal and Acquisition of Shares by a Public Benefit Organisation, it was ruled that BEE shares are ranked *pari passu* with ordinary shares in respect of dividends.

²³² Section 7 of the Unemployment Insurance Contributions Act 4 of 2002.

This inclusion was confirmed in *Lion Match Company (Pty) Ltd v Commissioner for the South African Revenue Service*.²³³ After April 2006, approved PBOs enjoy preferential tax treatment in terms of section 63A of the Eighth Schedule to the Act. An approved PBO may only issue tax-deductible certificates to its donors in respect of donations received provided that such PBO fulfils the requirements in terms of section 18A of the Act. The section 18A tax certificate allows donors to deduct a certain amount from their taxable income.

The Davis Tax Committee reported that there is a massive delay in the approval of PBOs in terms of sections 30, 10(1)(cN) and 18A of the Act. It affects the flow of donations to approved PBOs negatively. It also slows down the implementation of public benefit activities as set out in a PBO's founding document. The delays at SARS can be some of the reasons why the number of approved PBOs is significantly lower than the accumulated total registered NPOs, PBCs, Trusts, including the number of association of persons in South Africa.

The next chapter discusses charities and their tax implications in England and Wales.

²³³ *Lion Match Company (Pty) Ltd v Commissioner for the South African Revenue Service* (301/2017) (2018) ZASCA 36 (27 March 2018) 385.

CHAPTER 3

CHARITIES IN ENGLAND AND WALES

3.1 Introduction

Charitable work aimed initially at helping poor people has an elongated track record in the United Kingdom (UK). The charitable work over the years stretched to many countries all over the world. The first charity started in Britain more than 900 years ago. The King's School Canterbury that was founded in 597 and re-founded in c1541 is the oldest charity in the United Kingdom.²³⁴ The school enjoys the status as a registered charity and a registered company.²³⁵ The school can raise money through donations and generate income through business or trading activities.²³⁶ This allowed The King's School Canterbury to continue to offer its services as a school with the additional revenue generated through business or trading activities.²³⁷

The Charities Act 2011 established the Charity Commission to regulate the powers and functions of charities in the United Kingdom.²³⁸ The Charities Act 2011 describes the statutory objectives, functions, powers and duties of the Charity Commission.²³⁹ No Minister of the Crown or any government department in the United Kingdom has any control over the Charity Commission.²⁴⁰ The Charity Commission must however, function within the legislative framework²⁴¹ and the administrative controls of Treasury.²⁴²

All charities in the United Kingdom with an yearly income of £5 000 and above have to register with the Charity Commission.²⁴³ Organisations that are registered as a

²³⁴ Lake <https://fundraising.co.uk/2001/06/19/oldest-charity-england-and-wales/> (Date of use: 16 October 2021).

²³⁵ <https://www.supportingkings.co.uk/home> (Date of use: 19 November 2022).

²³⁶ <https://register-of-charities.charitycommission.gov.uk/charity-search/-/charity-details/307942/financial-history> (Date of use: 19 November 2022).

²³⁷ <https://register-of-charities.charitycommission.gov.uk/charity-search/-/charity-details/307942/financial-history> (Date of use: 19 November 2022).

²³⁸ Section 13(1) of Part 2 of the Charities Act 2011.

²³⁹ Sections 14, 15 and 16 of Part 2 of the Charities Act 2011.

²⁴⁰ Section 13(3) and 13(4) of Part 2 of the Charities Act 2011.

²⁴¹ Section 13(5)(a) of Part 2 of the Charities Act 2011.

²⁴² Section 13(5)(b) of Part 2 of the Charities Act 2011.

²⁴³ Charity Commission Guide <https://www.gov.uk/setting-up-charity/register-your-charity> (Date of use: 19 December 2019).

charitable incorporated organisation (CIO) also have to register with the Charity Commission.²⁴⁴ The register of the Charity Commission contains information of the name of every charity under section 30 of the Charities Act 2011,²⁴⁵ its number, date of registration, when and where it operates, income and sources of revenue, the sector in which it works, and it highlights the top ten charities in the United Kingdom.²⁴⁶ If the Charity Commission no longer considers an institution as a charity or if a charity ceases to exist or no longer operates as a charity in the United Kingdom, the Charity Commission can remove a charity from its register.²⁴⁷

Section 14 of the Charities Act 2011 describes the five objectives of the Charity Commission to be that of the public confidence objective,²⁴⁸ the public benefit objective,²⁴⁹ the compliance objective,²⁵⁰ the charitable resources objective²⁵¹ and the accountability objective.²⁵² Sections 15²⁵³ and 16 of the Charities Act 2011 describes in detail the common functions and the universal duties of the Charity Commission.²⁵⁴

²⁴⁴ Section 15(4) of Part 2 of the Charities Act 2011.

²⁴⁵ Section 29(2) of Part 2 of the Charities Act 2011.

²⁴⁶ Charity Commission Guide: <https://www.gov.uk/find-charity-information> (Date of use: 19 December 2019).

²⁴⁷ Section 34 of Part 2 of the Charities Act 2011.

²⁴⁸ Section 14(1) of Part 2 of the Charities Act 2011 defines the “public confidence objective” as “aiming to increase public trust and confidence in charities”.

²⁴⁹ Section 14(2) of Part 2 of the Charities Act 2011 defines the “public benefit objective” as “to promote awareness and understanding of the operation of the public benefit requirement”.

²⁵⁰ Section 14(3) of Part 2 of the Charities Act 2011 defines the “compliance objective” as “to promote compliance by the charity trustees with their legal obligations in exercising control and management of the administration of their charities”.

²⁵¹ Section 14(4) of Part 2 of the Charities Act 2011 defines the “charitable resources objective” as “to promote the effective use of charitable resources”.

²⁵² Section 14(5) of Part 2 of the Charities Act 2011 defines the “accountability objective” as “to enhance the accountability of charities to donors, beneficiaries, and the general public”.

²⁵³ Section 15 of Part 2 of the Charities Act 2011 describes the general functions of the Charity Commission as

15(1)(1) determining whether institutions are or are not charities; 15(1)(2) Encouraging and facilitating the better administration of charities; 15(1)(3) Identifying and investigating apparent misconduct or mismanagement in the administration of charities and taking remedial or protective action in connection with misconduct or mismanagement in the administration of charities; 15(1)(4) Determining whether public collections certificates should be issued, and remain in force, in respect of public charitable collections; 15(1)(5) Obtaining, evaluating and disseminating information in connection with the performance of any of the Commission's functions or meeting any of its objectives; and 15(1)(6) Giving information or advice, or making proposals, to any Minister of the Crown on matters relating to any of the Commission's functions or meeting any of its objectives.

²⁵⁴ Sections 15 and 16 of Part 2 of the Charities Act 2011.

The Charity Commission may in terms of section 15(2) of the Charities Act give guidance to give effect to its mandate.²⁵⁵ Section 15(2) of the Charities Act places a legislative responsibility on the Commission to fulfil one of its general functions which is to give appropriate advice and guidance about the administration of charities in England and Wales.²⁵⁶ The Commission publishes guides on its website, from time to time. The guides are available and accessible on the Commission's website. The Commission's guides are referred to in this chapter and will, therefore, not be discussed in detail under this heading because it is not the core focus of this research paper.

The chapter provides an overview of the registration and regulations of charities in England and Wales under the Charities Act. The emphasis of this chapter is on assessing the tax legislation with a specific focus on the legal requirements and regulations of trading activities of registered charities.

3.2 Legal requirements of registering a charity in England and Wales

The United Kingdom (UK) includes England, Wales, Northern Ireland, and Scotland. If an organisation wants to function as a charity in the UK, the organisation is obligated to satisfy the requirements set out in the definition of a "charity" in terms of the relevant sections in Charities Act 2011 (Charities Act).²⁵⁷ A "charity"²⁵⁸ means

²⁵⁵ Section 15(2) of Part 2 of the Charities Act 2011.

²⁵⁶ Section 15(2) of Part 2 of the Charities Act 2011.

²⁵⁷ Section 1 of Part 1 the Charities Act 2011.

²⁵⁸ Section 1 of Part 1 of the Charities Act 2011.

any institution²⁵⁹ which is established for charitable purposes²⁶⁰ only, and that falls subject to the control of the High Court²⁶¹ in the exercise of its jurisdiction with respect to charities.²⁶²

The basic legal requirements for an organisation to register with the Charities Commission are to show that it wishes to operate as a charity, is established for a charitable purpose²⁶³ for the benefit of the public²⁶⁴ and that it is subject to the control of the High Court's charity laws jurisdiction.²⁶⁵

Section 3 of the Charities Act 2011 presents a comprehensive list of descriptions on the legal requirement "purpose".²⁶⁶ The list includes the following "purposes" to be deemed as "charitable purposes":

- (a) the prevention or relief of poverty;²⁶⁷
- (b) the advancement of education;²⁶⁸
- (c) the advancement of religion;²⁶⁹
- (d) the advancement of health or saving of lives;²⁷⁰
- (e) the advancement of citizenship or community development;²⁷¹

²⁵⁹ The word "institution" used in section 78(5) of the Charities Act 2006 includes unincorporated associations, trusts, and corporations. In *R (Independent Schools Council) v Charity Commissions for England and Wales* 2011 UKUT 421 (TCC) 13 October 2011 20 the court included all such bodies for consideration on matters relating to the 2006 Charities Act or to charity law generally.

²⁶⁰ The term "purpose" in section 3(1) of chapter 1 of the Charities Act 2011, as amended, is the prevention or relief of poverty; the advancement of education; the advancement of religion; the advancement of health or saving lives; the advancement of citizenship or community development; the advancement of arts, culture, heritage or science; the advancement of amateur sport, the advancement of human rights, conflict resolution or reconciliation or the promotion of religious or racial harmony or equality and diversity; the advancement of environmental protection or improvement; the relief of those in need because of youth, age, ill-health, disability, financial hardship or other disadvantage; the advancement of animal welfare; the promotion of the efficiency of the armed forces of the Crown or the efficiency of the police, fire and rescue services or ambulance services; any other purposes.

²⁶¹ Section 7(2)(b) of the Charities Act 2011 states that the reference to the "High Court" in section 1(1) of the Act will mean the Court in Session in terms of charities operating in Scotland. Section 8(2)(b) of the Charities Act 2011 states that the "High Court" referred to in section 1(1) of the Act, also means the High Court in Northern Ireland.

²⁶² Charities Commission for Wales and England Guidance CC4 "What makes a charity" (CC4) 1 September 2013 explains that the inclusion of the high court jurisdiction in the definition of charity in section 1 of the Charities Act 2011 means that the governing document adopts the laws of England and Wales; most of the property of the organisation is located in England and Wales and the organisation's centre of administration is in England and Wales Part 5.

²⁶³ Section 2 of Part 1 of the Charities Act 2011.

²⁶⁴ Section 4 of Part 1 of the Charities Act 2011.

²⁶⁵ Section 1(b) of Part 1 of the Charities Act 2011.

²⁶⁶ Section 3 of Part 1 of the Charities Act 2011.

²⁶⁷ Section 3(1)(a) of Part 1 of the Charities Act 2011.

²⁶⁸ Section 3(1)(b) of Part 1 of the Charities Act 2011.

²⁶⁹ Section 3(1)(c) of Part 1 of the Charities Act 2011.

²⁷⁰ Section 3(1)(d) of Part 1 of the Charities Act 2011.

²⁷¹ Section 3(1)(e) of Part 1 of the Charities Act 2011.

- (f) the advancement of arts, culture, heritage or science;²⁷²
- (g) the advancement of amateur sport;²⁷³
- (h) the advancement of human rights, conflict resolution or reconciliation or the promotion of religious or racial harmony or equality and diversity;²⁷⁴
- (i) the advancement of environmental protection or improvement;²⁷⁵
- (j) the relief of those in need by reason of youth, age, ill-health, disability, financial hardship or other disadvantage;²⁷⁶
- (k) the advancement of animal welfare;²⁷⁷
- (l) the promotion of the efficiency of the armed forces of the Crown, or of the efficiency of the police, fire and rescue services or ambulance services;²⁷⁸ and
- (m) any other purposes that are not within paragraphs (a) – (l), but are recognised as charitable purposes by virtue of section 5 (recreational and similar trusts, etc.) or under the old law, ...²⁷⁹

A second legal requirement is that the “purpose” must “be for public benefit”.²⁸⁰ The Charity Commission uses the “public benefit test” to determine if an organisation qualifies as a charity or not. The public benefit test is that the charity’s purpose must be beneficial²⁸¹ and available to the general public.²⁸²

In *R (Independent Schools Council) v Charity Commission for England and Wales* [2011] UKUT 421 (TCC) (13 October 2011) the court discussed the meaning of the word “charity” and the meaning of “public benefit”. An institution will only be registered as a charity if it can prove that the reason for its establishment is for a charitable purpose and that it is subject to the control of the High Court’s charity laws jurisdiction.²⁸³ After the institution proves that its purpose meets the requirements of the list of purposes described in section 2(1)(a) of the Charities Act, it must prove in terms of section 2(1)(b) of the Act that the said purpose is “for the

²⁷² Section 3 (1)(f) of Part 1 of the Charities Act 2011.

²⁷³ Section 3(1)(g) of Part 1 of the Charities Act 2011.

²⁷⁴ Section 3(1)(h) of Part 1 of the Charities Act 2011.

²⁷⁵ Section 3(1)(i) of Part 1 of the Charities Act 2011.

²⁷⁶ Section 3(1)(j) of Part 1 of the Charities Act 2011.

²⁷⁷ Section 3(1)(k) of Part 1 of the Charities Act 2011.

²⁷⁸ Section 3(1)(l) of Part 1 of the Charities Act 2011.

²⁷⁹ Section 3(1)(m) of Part 1 of the Charities Act 2011.

²⁸⁰ Section 4 of Part 1 of the Charities Act 2011.

²⁸¹ The Charity Commission Guidance <https://www.gov.uk/guidance/public-benefit-rules-for-charities#the-public-benefit-requirement> (Date of use: 22 December 2019) explains that the benefit must be identifiable and capable of being proved by evidence where necessary. Any detriment or harm that results from the purpose (to people, property or the environment) must not outweigh the benefit.

²⁸² Charity Commission Guidance <https://www.gov.uk/guidance/public-benefit-rules-for-charities#the-public-benefit-requirement> (Date of use: 22 December 2019).

²⁸³ Section 1(1) of the Charities Act 2011.

benefit of the public” to comply with the meaning of the term “charitable purpose”.²⁸⁴ An institution will not be allowed to register with the Charity Commission as a charity if it fails to comply with the said legal requirements.²⁸⁵ Section 15(1)(1) of the Charities Act gives the Charity Commission a general function to “determine whether institutions are or are not charities”.²⁸⁶ The court in *R (Independent Schools Council) v Charity Commission for England and Wales* [2011] UKUT 421 (TCC) (13 October 2011) held that the charitable status of a school depends on its primary purpose that sets out what it does and what it does not do.²⁸⁷ The written Constitution of the school describes the purpose why the school was established.²⁸⁸ The court further held that where no written Constitution exists, it looks at what the purposes of the schools are and the historical implementation of this purpose.²⁸⁹ The court stated that the object of the charity must be to benefit the poor and not merely token or *de minimus*²⁹⁰ before such an object satisfies the requirement of public benefit.

The words “charity” and “charitable purposes” mentioned in the previous paragraph, have the same meaning in Scotland and Ireland. In Scotland, it refers to the laws of Scotland.²⁹¹ In Northern Ireland, it refers to the laws of Northern Ireland.²⁹² All organisations that want to operate as charities in Northern Ireland must register with the Charity Commission for Northern Ireland.²⁹³ In Scotland, an organisation must register with the Scottish Charity Regulator.²⁹⁴

The Charity Commission for England and Wales recognises four different types of legal entities that are eligible to register as a charity, namely, a Charitable

²⁸⁴ Section 2 of the Charities Act 2011.

²⁸⁵ Section 1(1) of the Charities Act 2011.

²⁸⁶ Section 15(1)(1) of the Charities Act 2011.

²⁸⁷ *R (Independent Schools Council) v Charity Commission for England and Wales* (2011) UKUT 421 (TCC) paragraph 191.

²⁸⁸ *R (Independent Schools Council) v Charity Commission for England and Wales* (2011) UKUT 421 (TCC) paragraph 187.

²⁸⁹ *R (Independent Schools Council) v Charity Commission for England and Wales* (2011) UKUT 421 (TCC) paragraph 193.

²⁹⁰ *R (Independent Schools Council) v Charity Commissioner for England and Wales* (2011) UKUT 421 (TCC) 222.

²⁹¹ Section 7(2)(a) of the Charities Act 2011.

²⁹² Section 8(2)(a) of the Charities Act 2011.

²⁹³ Section 16(2) of the Charities (Northern Ireland) Act 2008.

²⁹⁴ Section 1(5) of the Charities and Trustee Investment (Scotland) Act 2005.

Incorporated Organisation (CIO),²⁹⁵ a charitable company (limited by guarantee),²⁹⁶ an unincorporated charitable association,²⁹⁷ and a trust.²⁹⁸ The Charity Commission in Northern Ireland recognises three main legal entities as charities, namely, an unincorporated association,²⁹⁹ a charitable company,³⁰⁰ and a charitable trust.³⁰¹ The Scottish Charity Regulator recognises five different types of legal entities, namely, a company,³⁰² an incorporated association,³⁰³ a trust, a Scottish Charitable Incorporated Organisation (SCIO),³⁰⁴ or a Community Benefit Society.³⁰⁵

The general rule in terms of section 30(1) of the Charities Act 2011 is that every charity in England and Wales must register with the Charity Commission except the charities that fall under the categories in terms of section 30(2) of the said Act.³⁰⁶ Charities that falls in the list of categories mentioned in Schedule 3 to the Charities Act 2011 and those known as exempt charities³⁰⁷ are excluded from the legal obligation to register as a charity with the Charity Commission.³⁰⁸ If the Commission permanently or temporarily orders a charity to be exempt, the said charity complies

²⁹⁵ <https://www.gov.uk/setting-up-charity/register-your-charity> (Date of use: 13 August 2020) explains that this form of legal entity is registered with the Charity Commission for England and Wales and that the Trustees of such an entity have limited or no liability for the debts or liabilities of such legal entity.

²⁹⁶ <https://www.gov.uk/setting-up-charity/register-your-charity> (Date of use: 13 August 2020) describes this form of legal entity as a company with limited guarantee rather than shares, costing £40 to set up and within which the Trustees have limited or no liability for such a company's debts or liabilities. It means the same for England, Wales, Northern Ireland, and Scotland.

²⁹⁷ <https://www.gov.uk/setting-up-charity/register-your-charity> (Date of use: 13 August 2020) describes this form of legal entity to mean a group of volunteers that run a charity for a common purpose. The entity cannot employ any staff or own premises.

²⁹⁸ Charity Commission for England and Wales Guide <https://www.gov.uk/guidance/charity-types-how-to-choose-a-structure#types-of-charity-structure> (Date of use: 10 October 2021) describes the four main types of legal entities that are recognised.

²⁹⁹ The meaning of this form of legal entity is the same as in England and Wales.

³⁰⁰ <https://www.gov.uk/setting-up-charity/register-your-charity> (Date of use: 13 August 2020).

³⁰¹ The Charity Commission for Northern Ireland EG039 Guide <https://www.charitycommissionni.org.uk/media/1270/20190531-eg039-starting-a-new-charity-v30.pdf> (Date of use: 10 October 2021).

³⁰² <https://www.gov.uk/setting-up-charity/register-your-charity> (Date of use: 13 August 2020).

³⁰³ This form of legal entity is set up in terms of section 2 of the Co-operative and Community Benefit Societies Act 2014.

³⁰⁴ https://www.oscr.org.uk/media/3113/cscios_a_guide.pdf (Date of use: 10 October 2021) This form of legal entity is unique to Scotland and is set up in terms of section 49 of the Scottish Charities and Trustee Investment (Scotland) Act 2005. Its existence depends upon being entered into the register of the Scottish Charity Regulator.

³⁰⁵ <https://www.oscr.org.uk/charities/guidance/glossary-of-terms#ScottishCharityRegulator> (Date of use: 10 October 2021).

³⁰⁶ Section 30(1) of Part 4 of the Charities Act 2011.

³⁰⁷ Section 22 of Part 3 of the Charities Act 2011.

³⁰⁸ Section 30(2)(a) of Part 4 of the Charities Act 2011.

with any exclusions and its maximum annual gross income does not exceed £100 000, the charity has no legal obligation to register with the Charity Commission.³⁰⁹ Where the Secretary of State make regulations to exempt charities and such charities comply the said regulations, the conditions of the exception and its annual gross income does not exceed £100 000, such charities are not legally obliged to register with the Charity Commission.³¹⁰ If a charity in England or Wales has a minimum gross income of at least £5 000 per annum it is legally obliged to register with the Charity Commission.³¹¹ A charity that is registered as a charitable incorporated organisation, may apply to the Charity Commission for registration as a charity for England and Wales under section .³¹² However, if the charities that comply with the requirements under subsections 30(2)(a), (b) and (c) are requested to register, then it will be obliged to register with the Charity Commission for England and Wales.³¹³ Failure to comply with the requirements under section 30 of the Charities Act 2011 in terms of registration with the Charity Commission for England and Wales result in the institution being held liable to pay normal tax levies and not enjoy the benefit of being recognised by His Majesty’s Revenue and Customs (HMRC) for various categories of tax exemption.

Organisations can register as any one of the recognised legal entities mentioned in the abovementioned paragraphs and it must register with the Charity Commission for England and Wales to operate as a charity in England and Wales. If a charity operates in Northern Ireland, it must register with the Charity Commission for Northern Ireland. A charity that operates in Scotland must register with the Scottish Charity Regulator. These organisations must be established for a charitable purpose, meaning that the charitable purpose must be for the public benefit. It further means that the organisation must be under the control of either the High Court in England or Wales if it is based in England or Wales, or with the High Court of Northern Ireland if it operates in Ireland or with the Court in Session if it operates in Scotland.

³⁰⁹ Section 30(2)(b) of Part 4 of the Charities Act 2011.

³¹⁰ Section 30(2)(c) of Part 4 of the Charities Act 2011.

³¹¹ Section 30(2)(d) of Part 4 of the Charities Act 2011.

³¹² <https://www.gov.uk/setting-up-charity/register-your-charity> (Date of use: 13 August 2020).

³¹³ Section 30(3) of Part 4 of the Charities Act 2011.

In Northern Ireland and Scotland, all organisations that want to operate as charities must register with the relevant Charity Commission or Charity Regulator. However, in England and Wales, organisations with a minimum income of £5 000 per annum or that are charitable incorporated organisations must register with the Charity Commission.³¹⁴ Any organisation operating in England and Wales with an annual income less than £5 000 is not obliged to register with the Charity Commission.³¹⁵ Once an organisation is a registered charity, it qualifies for preferential tax treatment under the provisions contained in the Income Tax Act 2007.

3.3 Charities and income tax

Registered charities qualify to apply to Her Majesty's Revenue and Customs (HMRC) to enjoy exemption from paying most income and capital gains tax levies provided the income is used for the implementation of their charitable purposes.³¹⁶ Charities that are registered as charitable companies can apply to HMRC for corporation tax relief on Gift aid gifts,³¹⁷ receive from or payroll giving gifts from individuals,³¹⁸ gifts from companies,³¹⁹ payments received from another charity,³²⁰ trading exemptions,³²¹ miscellaneous income,³²² fundraising events,³²³ Lotteries,³²⁴ property income,³²⁵ investment income,³²⁶ public revenue dividends,³²⁷ annual payments³²⁸ or estate income.³²⁹ Charitable trusts qualify to apply to HMRC for preferential tax treatment in terms of sections 521 to 536 of the Income Tax Act 2007.³³⁰ This research paper will not discuss all tax relief in detail but will focus on a charity undertaking business or trading activities.

³¹⁴ <https://www.gov.uk/setting-up-charity/register-your-charity> (Date of use: 10 October 2021).
³¹⁵ <https://www.gov.uk/setting-up-charity/register-your-charity> (Date of use: 10 October 2021).
³¹⁶ <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-i-tax-exemptions-for-charities> (Date of use: 19 November 2022).
³¹⁷ Section 472(4) of Part 11 of the Corporation Tax Act 2010.
³¹⁸ Section 472A (3) of Part 11 of the Corporation Tax Act 2010.
³¹⁹ Section 473(3) of Part 11 of the Corporation Tax Act 2010.
³²⁰ Section 474(5) of Part 11 of the Corporation Tax Act 2010.
³²¹ Sections 478(5) and 480(6) of Part 11 of the Corporation Tax Act 2010.
³²² Section 481(6) of Part 11 of the Corporation Tax Act 2010.
³²³ Section 483(4) of Part 11 of the Corporation Tax Act 2010.
³²⁴ Section 484(4) of Part 11 the Corporation Tax Act 2010.
³²⁵ Section 485(5) of Part 11 of the Corporation Tax Act 2010.
³²⁶ Section 486(6) of Part 11 pf the Corporation Tax Act 2010.
³²⁷ Section 487(3) of Part 11 of the Corporation Tax Act 2010.
³²⁸ Section 488(4) of Part 11 of the Corporation Tax Act 2010.
³²⁹ Section 489(3) of Part 11 of the Corporation Tax Act 2010.
³³⁰ <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-i-tax-exemptions-for-charities> ((Date of use: 19 November 2022).

HMRC, established in terms of sections 1 to 4 of the Commissioners for Revenue and Customs Act 2005, is responsible for the collection of revenue that includes income tax and capital gains tax.³³¹ HMRC guidance merely provides information to the public on how HMRC interprets and applies the provisions of tax legislation.³³² When determining if charities qualify for tax relief on income and capital gains, HMRC advises that it considers four main factors.³³³ Although, the guidance published by HMRC has no legal status, it helps the public to understand how the body makes its decisions when applying the tax legislation.

Section 30 read with Part 1 of Schedule 6 to the Finance Act 2010 defines a “charity”, “charitable company” and a “charitable trust” for the purposes of enjoying any form of tax relief under the tax legislation.³³⁴ According to the HMRC guidance explains that “a body of persons includes companies, unincorporated associations and other groups.”³³⁵ The Finance Act 2010 requires that an institution must prove that it was established for a “charitable purpose” and that it satisfies three other conditions before such an institution will be recognised as a charity for the purpose of enjoyment of any tax relief.³³⁶ A “charitable purpose” to mean any of the purposes described in section 3(1) and that is implemented for the “public benefit” in terms of section 4 of the Charities Act 2011.³³⁷ The HMRC guidance explains that an organisation satisfies the condition “charitable purpose” if the governing or founding document limits the organisation to use the income and assets to only for the fulfilling of the organisation’s “charitable purpose”.³³⁸ The “jurisdiction condition” is that the “body of persons” or “trust” must comply with the requirements contained in paragraph 2 of Part 1 of Schedule 6 of the Finance Act 2010.³³⁹ The Finance Act

³³¹ Section 5 of the Commissioners for Revenue and Customs Act 2005.

³³² <https://www.gov.uk/government/organisations/hm-revenue-customs/about/publication-scheme#publication-scheme> (Date of use: 19 November 2022).

³³³ <https://www.gov.uk/charities-and-tax/tax-reliefs> (Date of use: 19 November 2022).

³³⁴ Section 30 read with Part 1 of Schedule 6 to the Finance Act 2010.

³³⁵ HMRC Guidance Chapter 2: Applications for recognition as a charity for tax purposes 18 November 2022 <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/chapter-2-applications-for-recognition-as-a-charity-for-tax-purposes> (Date of use: 19 November 2022).

³³⁶ Paragraph 1 of Part 1 of Schedule 6 to the Finance Act 2010.

³³⁷ Section 2 of the Charities Act 2011.

³³⁸ HMRC Guidance Chapter 2: Applications for recognition as a charity for tax purposes 18 November 2022 <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/chapter-2-applications-for-recognition-as-a-charity-for-tax-purposes> (Date of use: 19 November 2022).

³³⁹ Paragraph 2 of Part 1 of Schedule 6 to the Finance Act 2010.

2011 explains that the “jurisdiction condition” means that the organisation must be “subject to the control of a relevant UK court with respect to charities” or “any other court in the exercising of a corresponding jurisdiction under the law of a relevant territory”.³⁴⁰ The “registration condition” requires an organisation in England and Wales to be duly registered with the Charity Commission under section 29 of the Charities Act 2011.³⁴¹ The “management condition” requires the persons who control and manages the organisation must satisfy the “fit and proper persons” test.³⁴² The HMRC guide explains that in the absence of an explanation in the legislation, it will accept all appointed managers of an organisation to satisfy the requirement of a “fit and proper” person unless the opposite is proved.³⁴³ The said guide emphasis that where the opposite is proven, the organisation will not lose its preferential tax treatment but would rather withhold any repayments to the said charity.³⁴⁴

The Income Tax Act 2007 makes provision for charitable trusts that are based in the United Kingdom to enjoy preferential tax treatment on certain income and gains received in a tax year.³⁴⁵ Sections 520 to 523 of the Income Tax Act 2007 sets out the tax relief if a donor donates a gift to a charitable trust and the said gift qualifies as a qualifying donation under Chapter 2 of Part of the Income Tax Act 2007.³⁴⁶ Sections 524 to 537 of the Income Tax Act 2007 explains when “charitable trusts and others” will not be liable to pay income tax levies on income .³⁴⁷ Charitable companies may in terms of sections 466 to 493 of the Corporation Tax Act 2010 apply to HMRC for allowed exemptions from paying income tax and capital gains levies.³⁴⁸

³⁴⁰ Paragraph 2(1) read with paragraphs 2(2) and 2(3) of Part 1 of Schedule 6 to the Finance Act 2010.

³⁴¹ Paragraphs 3(1)(a) and 3(2) of Part 1 of Schedule 6 to the Finance Act 2010.

³⁴² Paragraph 4 of Part 1 of Schedule 6 to the Finance Act 2010.

³⁴³ HMRC Guidance on the fit and proper persons test 9 March 2017 <https://www.gov.uk/government/publications/charities-fit-and-proper-persons-test/guidance-on-the-fit-and-proper-persons-test> (Date of use: 20 November 2022).

³⁴⁴ HMRC Guidance on the fit and proper persons test 9 March 2017 <https://www.gov.uk/government/publications/charities-fit-and-proper-persons-test/guidance-on-the-fit-and-proper-persons-test> (Date of use: 20 November 2022).

³⁴⁵ Section 518(2) of Part 10 of the Income Tax Act 2007.

³⁴⁶ Section 520 of Part 10 of the Income Tax Act 2007.

³⁴⁷ Sections 518(2) of Part 10 of the Income Tax Act 2007.

³⁴⁸ Section 466 of Part 11 of the Corporation Tax Act 2010.

The charity must register with HMRC on its available website.³⁴⁹ Once an organisation satisfies the condition of “charitable purpose”, it will qualify for preferential tax treatment in terms of both income and capital gains tax, namely profits from trading, rental or investment, profits when an asset like property or shares is sold or disposed of and when a charity buys property.³⁵⁰

Charities do not pay tax on dividends if the income received from the dividends is used to satisfy its “charitable purpose”.³⁵¹

3.4 Charities and trading activities

Three different Acts applicable to the trading activities of charities in England and Wales, namely the Income Tax (Trading and Other Income) Act 2005 (ITTOIA), Income Tax Act 2007 and Corporation Tax Act 2010, will be discussed under this heading. Therefore, the discussion that follows will only highlight the different sections in the said legislation that are applicable to explain the income tax implications of trading activities of charities in England and Wales. The ITTOIA governs the tax implications of income received from the profits of trading activity, “property, savings and investment and certain other income”.³⁵² The Income Tax Act 2007 deal with the tax implications of income received in a year of assessment.³⁵³ The Corporation Tax Act deal with the tax implication of corporations, company distributions and other related matters.³⁵⁴

Section 5 of the ITTOIA states that “[i]ncome tax is charged on the profits of a trade, profession or vocation”.³⁵⁵ Section 108 of Part 2 of the ITTOIA explains that if “a person carrying on a trade” donates the proceeds of an article that is “manufactured, or of a class or description” that is “sold by the donor in the course of the trade” such profit will be exempt when calculating the total amount in profit of the trade for tax purposes.³⁵⁶ However the calculation of the total profit of the trade must include the

³⁴⁹ See <https://www.tax.service.gov.uk/hmrc-register-charity-details/eligible-purposes> for the online process (Date of use: 29 September 2019).

³⁵⁰ Paragraph 1(4)(a) of Part 1 of Schedule 6 to the Finance Act 2010.

³⁵¹ Section 486 of the Corporation Tax Act 2010.

³⁵² Introductory text of the ITTOIA 2002.

³⁵³ Introductory text of the Income Tax Act 2007.

³⁵⁴ Introductory text of the Corporations Tax Act 2010.

³⁵⁵ Section 5 of ITTOIA 2005.

³⁵⁶ Section 108 of Part 2 of the ITTOIA 2005.

value of the portion of the benefit if the said donor or “connected person” to the donor receives a benefit from making the article.³⁵⁷ Where a donor permanently stopped trading activities the “amount equal to the value of the benefit” is deemed as a “post-cessation receipt when calculating the profits of the trade.”³⁵⁸ Section 246 of the ITTOIA explains that the term “post-cessation receipt” means “a sum which is received after a person permanently ceases on of the trade, and which arises from the carrying on of the trade before the cessation”.³⁵⁹Section 245 means that when a charity receives or is entitled to receive a “post-cessation” receipt, such a charity is liable to pay income tax.³⁶⁰

A charitable trust is exempt from paying an income tax levy on the total income received from trade activities when it complies with the conditions in subsections 524(3) and (4) of the Income Tax Act 2007.³⁶¹

The Income Tax Act 2007 exempts charitable trusts from paying an income tax levy on the income received from “charitable trade” if sections 524(3) and (4) are complied with. Condition A is that the profits from a trade, or the amount treated as “adjustment income” or a “post-cessation receipt”³⁶², of the trade in relation to the tax year, must be charitable trade. The term “adjustment income” is defined in section 228 of the ITTOIA to mean the result of a positive amount after calculating an adjustment in accordance with the formula explained in section 231 of the same Act.³⁶³

³⁵⁷ Section 109 of Part 2 of the ITTOIA 2005.

³⁵⁸ Section 109(2)(b) of the ITTOIA 2005.

³⁵⁹ Section 246(1) of the ITTOIA 2005

³⁶⁰ Section 245 of the ITTOIA 2005.

³⁶¹ Sections 524(3) and 524(4) of the Income Tax Act 2007.

³⁶² Section 246(1) of the ITTOIA 2005.

³⁶³ Section 228(1), 228(2) and 231 of the ITTOIA 2005.

The term “charitable trade”,³⁶⁴ in section 525 of the Income Tax Act 2007, means the trade exercised in the course of carrying out a primary purpose³⁶⁵ of the charitable trust,³⁶⁶ or the work in connection with the trade is mainly carried out by the beneficiaries of the charitable trust.³⁶⁷

Condition A is that the profits from a trade, or the amount treated as “adjustment income” or a “post-cessation receipt” of the trade in relation to the tax year, must be “charitable trade”.³⁶⁸ Condition B is that profits are, or the sum treated as adjustable income or the post-cessation receipt of the trade, is only applied for the charitable trust.³⁶⁹ A charitable trust does not enjoy one hundred percent relief from paying income tax when conducting a trade that is not regarded as a “charitable trade”.³⁷⁰ A charitable trust enjoys preferential tax treatment only for the trading activities exercised in implementing the primary purpose of the charitable trust,³⁷¹ or if a trading activity is carried out by the beneficiaries of a charitable trust.³⁷²

A corporation tax levy is charged on the income that companies receive from the profit on its trading activities.³⁷³ Section 478 of the Corporations Tax Act 2010 allows a charitable company to exclude the income that falls into the scope of section 478(2), meaning the income received from the profits of or “post-cessation receipts” deriving from “charitable trading”³⁷⁴ of the said charitable company.³⁷⁵ The term “charitable company” means “a charity which is a company”.³⁷⁶ When a charitable company receives income from a trading activity, such income is excluded from calculating the total sum of chargeable corporation tax levy for the year of

³⁶⁴ The term “charitable trade” is defined by section 479(1)(a) and (b) of the Corporations Tax Act 2010, as amended to mean

the trade is exercised in the course of carrying out a primary purpose of the charitable company or the work in connection with the trade is mainly carried out by the beneficiaries of the charitable company.

³⁶⁵ The primary purpose of a charity is described in the governing document of a charity which must fall within one of the items on the list provided for in section 3(1) of the Charities Act 2011, as amended for charities based in England or Wales.

³⁶⁶ Section 525(1)(a) of the Income Tax Act 2007.

³⁶⁷ Section 525(1)(b) of the Income Tax Act 2007.

³⁶⁸ Section 542(3) of the Income Tax Act 2007.

³⁶⁹ Section 524(4) of the Income Tax Act 2007.

³⁷⁰ Section 524 of the Income Tax Act 2007.

³⁷¹ Section 525(2) of the Income Tax Act 2007.

³⁷² Section 525(3) of the Income Tax Act 2007.

³⁷³ Section 1(1) of the Corporation Tax Act 2010.

³⁷⁴ Section 479 of the Corporations Tax Act 2010 explains the term “charitable trade” as it relates to a charitable company.

³⁷⁵ Sections 478(1) and 478(2) of the Corporations Tax Act 2021.

³⁷⁶ Section 193 of the Charities Act 2011.

assessment if the said company complies with the conditions in section 478 and.³⁷⁷ Section 479 of the Corporation Tax Act 2010 explains the meaning of the term “charitable trade”.³⁷⁸ When a charitable company conducts a trade it must be exercised during the implementation of the “primary purpose” of the company.³⁷⁹ Section 479(2) of the Corporation Tax Act requires the charitable company to treat each trade separately when it performs trading activities to partly fulfil its primary purpose and partly otherwise when calculating the payable corporation tax levy payable.³⁸⁰ If the beneficiaries of the charitable company carry on the trading activities, such trade will qualify as “charitable trade” under section 479(2)(b) of the Corporation Tax Act.³⁸¹ Section 479(3) explains that if some trading activities are carried out by the beneficiaries of the charitable company and some trading activities by people who are not beneficiaries, the two categories of trade must be separated when calculating the payable corporation tax levy for the year of tax assessment.³⁸² HMRC gives several examples in its guidance called “Annex iv: trading and business activities – basic principles” to help the public better understand the application of the term “primary purpose” of a charitable company.³⁸³ An example is a registered charitable company that operates as a school that lets accommodation students during school term-time and also lets out the same accommodation to tourists out of school term-times.³⁸⁴ HMRC explains that the income generated from letting the service accommodation to students during school term-time is regarded as “charitable trade” because it is generated from a trade that carries out the primary purpose of the school.³⁸⁵ The profit generated from charitable trade is exempted from paying a corporation tax levy.³⁸⁶ The profit that is generated

³⁷⁷ Sections 478 of the Corporations Tax Act 2010.

³⁷⁸ Section 479 of the Corporation Tax Act 2010.

³⁷⁹ Section 479(1)(a) of the Corporation Tax Act 2010.

³⁸⁰ Section 479(2) of the Corporation Tax Act 2010.

³⁸¹ Section 479(2)(b) of the Corporation Tax Act 2010.

³⁸² Section 479(3) of the Corporation Tax Act 2010.

³⁸³ <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-iv-trading-and-business-activities-basic-principles#trading-which-is-not-wholly-charitable-trading> (Date of use: 20 November 2022).

³⁸⁴ HMRC Guidance Annex iv: trading and business activities – basic principles (Updated 18 November 2022) Chapter 8 <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-iv-trading-and-business-activities-basic-principles#trading-which-is-not-wholly-charitable-trading> (Date of use: 20 November 2022).

³⁸⁵ HMRC Guidance Annex iv: trading and business activities – basic principles (Updated 18 November 2022) Chapter 8 <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-iv-trading-and-business-activities-basic-principles#trading-which-is-not-wholly-charitable-trading> (Date of use: 20 November 2022).

³⁸⁶ Sections 478(1) and 478(2)(b) of the Corporation Tax Act 2010.

from the letting of the same accommodation to tourists is not regarded as “charitable trade” and are therefore liable to pay a corporation tax levy.³⁸⁷

However, if the abovementioned profit generated from tourists falls in the category of small scale-trade and it complies with the requirements of section 480 of the Corporation Tax Act 2010, such income qualifies to be exempt from a corporation tax levy.³⁸⁸ The non-charitable trading turnover³⁸⁸ must in terms of section 482(6) of the Corporation Tax Act 2010 fall below the prescribed limit set for small trading turnover.³⁸⁹ Section 528(6) of the Income Tax Act 2007 describes the prescribed limit of the profit that charitable trusts generate from “non-exempt” trade.³⁹⁰

A charitable company can still exclude the total sum profit of income derived from “charitable trade” and “miscellaneous income resources” during the tax year of assessment.³⁹¹ However, the said income must comply with the prescribed limit³⁹², or at the commencement of the accounting period, the charitable company had a “reasonable expectation” that the total profits from trade will not exceed the prescribed limit for small trading turnover³⁹³.³⁹⁴ The term “income resources” is defined in section 482(2) of the Corporation Tax Act 2010 as the income a charitable company receives from “non-exempt trade”³⁹⁵ and “which are post-cessation receipts that arises from such trade”³⁹⁶.³⁹⁷ HMRC provides an example to help explain the practical application of the calculation to determine if a corporate tax

³⁸⁷ Sections 478 and 479 of the Corporation Tax Act 2010.

³⁸⁸ Section 480 of the Corporation Tax Act 2010.

³⁸⁹ HMRC Guidance Annex iv: trading and business activities – basic principles (Updated 6 August 2019) Chapter 15 explains that the calculation of the annual turnover limit for non-charitable trade by a charity is prescribed at £8 000 and 25% of the total income resources, subject to a maximum of £80 000. The term “total income” in this instance means the total receipts of the charity for the year from all the monetary sources (grants, donations investment income, trading receipts) calculated with normal charity accounting rules and does not include any capital receipts such as from the sale of shares or property. <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-iv-trading-and-business-activities-basic-principles#exemption-for-small-scale-non-charitable-trading> (Date of use: 13 August 2020).

³⁹⁰ Section 528(6) of the Income Tax Act 2007.

³⁹¹ Section 482 of the Corporation Tax Act 2010.

³⁹² Section 482(1)(a) of the Corporation Tax Act 2010.

³⁹³ Section 482(1)(b) of the Corporation Tax Act 2010.

³⁹⁴ Section 482(1) of the Corporation Tax Act 2010.

³⁹⁵ Section 482(2)(a) of the Corporation Tax Act 2010.

³⁹⁶ Section 482(2)(b) of the Corporation Tax Act 2010.

³⁹⁷ Section 482(2) of the Corporation Tax Act 2010.

exemption applies or not.³⁹⁸ The guide explains the scenario of a charity that has a total turnover of £40 000 that the charity generated from “non-charitable trading”.³⁹⁹ The same charity generated a total profit of £150 000 from “incoming resources” for the accounting period.⁴⁰⁰ The amount of £150 000 includes the total turnover of £40 000 as mentioned at the start of this scenario.⁴⁰¹ Section 482(6)(a) of the Corporation Tax Act 2010 provides for a prescribed limit of not more than 25% of the total “incoming resources” for the year of assessment.⁴⁰² When applying the mandatory limit of section 482(6)(a) of the Corporation Tax Act 2010 the charity must calculate 25% of £150 000, which amounts to £37 500.⁴⁰³ This means that the total turnover of £40 000 is more than the mandatory allowed limit of £37 500 as per the said scenario and the full amount of £40 000 is taxable.⁴⁰⁴

However, if the charity had a “reasonable expectation” at the commencement of the accounting period that the sum profit total described in section 482(1)(a) would not exceed the requisite limit, the said profit could still be exempt from paying corporation tax.⁴⁰⁵ The profits from the “charitable” and “non-charitable” trade must be separated when calculating the amount of exempt and payable tax levies.⁴⁰⁶ Sections 479(2) and (3) of the Corporate Tax Act 2010 apply to a registered

³⁹⁸ HMRC Guidance Annex iv: trading and business activities – basic principles (Updated 18 November 2022) Chapter 15 <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-iv-trading-and-business-activities-basic-principles#trading-which-is-not-wholly-charitable-trading> (Date of use: 20 November 2022).

³⁹⁹ HMRC Guidance Annex iv: trading and business activities – basic principles (Updated 18 November 2022) Chapter 15 <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-iv-trading-and-business-activities-basic-principles#trading-which-is-not-wholly-charitable-trading> (Date of use: 20 November 2022).

⁴⁰⁰ HMRC Guidance Annex iv: trading and business activities – basic principles (Updated 18 November 2022) Chapter 15 <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-iv-trading-and-business-activities-basic-principles#trading-which-is-not-wholly-charitable-trading> (Date of use: 20 November 2022).

⁴⁰¹ HMRC Guidance Annex iv: trading and business activities – basic principles (Updated 18 November 2022) Chapter 15 <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-iv-trading-and-business-activities-basic-principles#trading-which-is-not-wholly-charitable-trading> (Date of use: 20 November 2022).

⁴⁰² Section 482(6)(a) of the Corporation Tax Act 2010.

⁴⁰³ Section 482(6)(a) of the Corporation Tax Act 2010.

⁴⁰⁴ Section 482 of the Corporation tax Act 2010 read together with HMRC Guidance Annex iv: trading and business activities – basic principles (Updated 18 November 2022) Chapter 15 <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-iv-trading-and-business-activities-basic-principles#trading-which-is-not-wholly-charitable-trading> (Date of use: 20 November 2022).

⁴⁰⁵ Section 482(1) of the Corporation Tax Act 2010.

⁴⁰⁶ Section 482 of the Corporation Tax Act 2010.

company. Sections 525(2) and (3) of the Income Tax Act 2007 apply to a registered charitable trust.

HMRC may disregard the entire income tax charge if a charity commenced on or after 21 March 2006 and if the charity has a mixture of charitable and non-charitable trading activities.⁴⁰⁷ The charity enjoys income tax relief in its entirety if the non-charitable part of the trade is insignificant in absolute terms to the trade part of the organisation and its total non-charitable turnover is less than 10% of the total turnover of the trade.⁴⁰⁸

A charity that carries on a significant scale of non-primary purpose trading may consider registering a “subsidiary trading company”⁴⁰⁹ to trade on its behalf. A subsidiary trading company is wholly owned⁴¹⁰ by a charity or a group of charities, to trade on its behalf to increase its financial resources. The charity or a group of charities can make a nominal amount of share capital available to help fund the subsidiary trading company’s trading activities. A subsidiary trading company will be liable for corporation tax on its profits in the same way as any other registered companies in the UK. The liability, is however, reduced or eliminated with Gift Aid to make payments⁴¹¹ to the parent charity. A detailed discussion on gift aid giving follows later in this chapter.

⁴⁰⁷ HMRC Guidance Annex iv: trading and business activities – basic principles (Updated 18 November 2022) Chapter 9 <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-iv-trading-and-business-activities-basic-principles#trading-which-is-not-wholly-charitable-trading> (Date of use: 20 November 2022).

⁴⁰⁸ Section 479 of the Corporation Tax Act 2010 and section 525(4) of the Income Tax Act 2007 read with HMRC Guidance Annex iv: trading and business activities – basic principles (Updated 18 November 2022) Chapter 9 <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-iv-trading-and-business-activities-basic-principles#primary-purpose-trading> (Date of use: 20 November 2022).

⁴⁰⁹ Section 185 of the Corporation Tax Act 2010 defines the term “trading company” to mean “a company the business of which consists wholly or mainly carrying on of a trade or trades”.

⁴¹⁰ The term “wholly owned” in section 200 of the Corporation Tax Act 2010 means that the company meets condition A or B. Condition A means that the company has an ordinary share capital and the charity owns every part of the share capital. Condition B means that the company is limited by guarantee that every beneficiary of that company is or must be a charity or a company wholly owned by a charity.

⁴¹¹ A subsidiary trading company may make payments to its parent charity in the form of a share dividend, interest on, and repayments of, loan capital, or as Gift aid. The most common form of payment is to pay Gift aid. <https://www.gov.uk/government/publications/trustees-trading-and-tax-how-charities-may-lawfully-trade-cc35/trustees-trading-and-tax-how-charities-may-lawfully-trade#s4> (Date of use: 13 August 2020).

3.5 Charities and capital gains tax

Section 256(1) of the Taxation of Chargeable Gains Act 1992 (“TCGA”) states that:

subject to section 505(3) of the Taxes Act and section 256(2) of the TCGA, a gain shall not be a chargeable if it accrues to a charity nor will it be applicable to or applied for charitable purposes.⁴¹²

Charities do not pay a capital gains tax levy if it the “gain accrues to a charity” and the said gain “is applicable or applied for charitable purpose”.⁴¹³ In *IRC v Helen Slater Charitable Trust* 53 TC 230, the court accepted the view that the terms “applied for charitable purposes” and “applicable to charitable purposes” have the same meaning.⁴¹⁴ The said exemption is subject to sections 505(3) of the Income and Corporations Taxes Act 1998 (ICTA) and section 256(2) of the Taxation of Chargeable Gains Act 1992 (TCA).⁴¹⁵ Charities can claim the relief for gains that accrued to it if during the assessment period the “relevant income and gains” do not exceed £10 000 or the “amount of its qualifying expenditure” and it did not incur or will be incurring non-qualifying expenditure”.⁴¹⁶ Section 505(5) of the ICTA defines “relevant income and gains” to mean any income and gains, excluding income and gains mentioned in section 505(1) of the said Act, that “would not be exempt from tax together with any income with any income and gains which is taxable notwithstanding the said subsection (1).⁴¹⁷

⁴¹² Section 256(2) of the TCGA 1992 states that

if property held on charitable trusts ceases to be subject to charitable trusts (a) the trustees shall be treated as if they had disposed of, and immediately reacquired, the property for a consideration equal to its market value, any gain on the disposal being treated as not accruing to a charity, and (b) if and so far as any of the property represents, directly or indirectly, the consideration for the disposal of assets by the trustees, any gain accruing on that disposal shall be treated as not having accrued to a charity; and an assessment to capital gains chargeable by virtue of paragraph (b) above may be made at any time not more than 3 years after the end of the year of assessment in which the property ceases to be subject to charitable trusts.

⁴¹³ Section 256(1) of the Taxation and Chargeable Gains Act 1992.

⁴¹⁴ *IRC v Helen Slater Charitable Trust* 1981 55 TC 230.

⁴¹⁵ Section 256(1) of the Taxation and Chargeable Gains Act 1992.

⁴¹⁶ Section 505(3) of the Income and Corporation Taxes Act 1998.

⁴¹⁷ Section 505(5) of the Income and Corporation Taxes Act 1998.

3.6 Charities and Gift Aid

If an individual or a corporate makes a qualifying donation⁴¹⁸ to a charity that is recognised by HMRC, they may claim Gift Aid at 25p for every £1 donated.⁴¹⁹ When an individual wants to claim Gift Aid, such individual must fulfil the three requirements set out in terms of section 414(1) of the Income Tax Act 2007.⁴²⁰ One of the requirements is that there must be no benefit associated with the gift,⁴²¹ or if this is the case, the benefit associated with the gift must fulfil the conditions that are comprehensively outlined in section 418 of the Income Tax Act 2007.

A corporate donation does not contain the element of “gift” as one of its components. HMRC Guide states that the donor must have paid Income Tax or Capital Gains Tax, equal to the Gift Aid amount, in the same tax year of assessment that the donor wants to claim in that year.⁴²² The donor who wants to claim Gift Aid, must make a Gift Aid Declaration⁴²³ in which the donor agrees to the Gift Aid amount claimed. HMRC Guide states that the following donations do not qualify for Gift Aid:

⁴¹⁸ Section 416 of the Income Tax Act 2007 describes the meaning of a qualifying donation when an individual makes such a donation to a recognised charity and section 191(1) of the Corporation Tax Act 2010 states that a payment made to a charity by a company is a qualifying payment for the purposes of this Chapter (Chapter 2: Certain payments to charities) if each of the conditions A to F is met. The conditions set out in A to F includes a payment made in the sum of money, a payment made that is not subject to a condition as to repayment as described in more detail in section 192 of the Corporation Tax Act 2010, the company making the payment is not itself a charity and that the payment is not disqualified under sections 193, 194 or 195 of the Corporation Tax Act 2010.

⁴¹⁹ <https://www.gov.uk/claim-gift-aid> (Date of use: 26 November 2019).

⁴²⁰ Section 414(1) of the Income Tax Act 2007 states that an individual who makes a gift to a charity which is a qualifying donation is entitled to the relief set out in subsection 2 which states that

the Income Tax Acts have effect in their application to the individual for the tax year in which the gift is made as if

(a) the gift had been made after the deduction income tax –

(i) at the Scottish basic rate if the individual is a Scottish taxpayer for that tax year, or

(ii) otherwise, at the basic rate, and

(b) the basic limit and the higher limit were increased by an amount equal to the grossed amount of the gift.

⁴²¹ The meaning of the term “benefits associated with a gift” is described in section 417 of the Income Tax Act as

a benefit associated with a gift for the purposes of this Chapter (Chapter 2: Gift Aid) if it is received by the individual who makes the gift, or a person connected with the individual, in consequence of making the gift.

⁴²² HMRC guide: Claiming Gift Aid as a charity or CASC <https://www.gov.uk/claim-gift-aid> (Date of use: 1 December 2019).

⁴²³ The HMRC guide provides examples of Gift Aid Declaration Forms for one-off donations, all donations, and sponsored events. Such declaration forms must include the name of the charity or CASC, the donor’s name and the donor’s home address. <https://www.gov.uk/claim-gift-aid> (Date of use: 1 December 2019).

- (a) received from limited companies, or
- (b) made through Payroll Giving, or
- (c) a payment made for goods and services because a charity bought the goods or services, or
- (d) a gift that started as a loan, but the charity no longer has to repay it, or
- (e) where the donor receives a benefit over a certain limit, or
- (f) donations from shares or charity cards or vouchers recognised by the HMRC.⁴²⁴

HMRC Guidelines sets out the special rules that apply to Gift aid claims when a charity receives funds from various sources such as funds received from “sponsored challenges.”⁴²⁵

A donor can also claim Gift Aid for small cash donations⁴²⁶ or contactless card donations⁴²⁷ of less than £30 on or after 6 April 2019. The charity or CASC must have claimed Gift Aid in the same tax year as it wants to claim under the Gift Aid small donations scheme (GASDS) without getting a penalty in the last two years. At least two of the past four years must be without a two-year gap between claims if it is claiming donations made before 6 April 2017. It does not require a Gift Aid Declaration Form to be completed and submitted online to HMRC.⁴²⁸

HMRC limits the amount to be claimed under this scheme not to be more than ten times the amount of Gift Aid claimed.⁴²⁹ No Gift Aid is allowed if a donation has a valid Gift Aid Declaration or is for membership fees or a donation that is a £30 portion of a more substantial gift.⁴³⁰ The maximum sum total of small donations top-up payments must not be more than £8 000 and can only be up to 10 times the amount of Gift Aid that was received by the charity or CASC.

⁴²⁴ <https://www.gov.uk/claim-gift-aid/what-you-can-claim-it-on> (Date of use: 1 December 2019).

⁴²⁵ <https://www.gov.uk/claim-gift-aid/what-you-can-claim-it-on> (Date of use: 1 December 2019).

⁴²⁶ The term “cash donations” means “donations given in coins or notes of any currency that have been collected and banked in the UK”. <https://www.gov.uk/guidance/claiming-a-top-up-payment-on-small-charitable-donations#collections-in-community-buildings> (Date of use: 1 December 2019).

⁴²⁷ The HMRC guide states that from 6 April 2017 charities or CASC can claim on donations using contactless technology such as a contactless credit or debit card and that you do not need to know the identities of the donors. <https://www.gov.uk/guidance/claiming-a-top-up-payment-on-small-charitable-donations#collections-in-community-buildings> (Date of use: 1 December 2019).

⁴²⁸ <https://www.gov.uk/claim-gift-aid> (Date of use: 1 December 2019).

⁴²⁹ <https://www.gov.uk/claim-gift-aid> (Date of use: 1 December 2019).

⁴³⁰ <https://www.gov.uk/claim-gift-aid> (Date of use: 1 December 2019).

If the charity owns a community building,⁴³¹ it is allowed to claim more than the restriction of up to £8 000 in terms of top-up payments.⁴³² Only small donations accumulated in the same Local Authority area⁴³³ is eligible for top-up payments for each community building. A Gift Aid claim under the GASDS of connected charities⁴³⁴ with different purposes and activities are connected.⁴³⁵

A company can claim Gift Aid under the Corporation Tax Act 2010 (CTA) if it donates to a charity. Section 189 of the CTA⁴³⁶ explains when

a qualifying charitable donation⁴³⁷ qualifies as a deduction from the company's total profits when calculating corporation tax chargeable for an accounting period.⁴³⁸

The section explains that the donations

are deducted from the company's total profit for the period after any other relief from corporation tax other than group relief for carried-forward losses.⁴³⁹

⁴³¹ The definition of "a community building" is a building (or part of a building) which a charity uses to run charitable activities that are provided for ten or more beneficiaries at least six times during the tax year and it must be available to members of the public.

See <https://www.gov.uk/claim-gift-aid> (Date of use: 1 December 2019) to read in more detail about the specific requirements to qualify as a community building.

⁴³² After 6 April 2017, charities can no longer claim a top-up payment on donations up to £8 000 per charity plus the additional amount of £8 000 of small donations for each community building they operate. The new rules are that charities with fewer than two community buildings can only claim under GASDS on a maximum of £8 000 on eligible small donations each tax year that is collected anywhere in the UK. Charities with two or more community buildings can either claim a top-up payment on donations of up to a maximum of £8 000 collected in each community building or a top-up payment on donations of up to £8 000 collected anywhere in the UK. <https://www.gov.uk/claim-gift-aid> (Date of use: 1 December 2019).

⁴³³ A Local Authority area is defined across the UK. <https://www.gov.uk/claim-gift-aid> (Date of use: 1 December 2019).

⁴³⁴ The term "connected charities" is understood as one charity that controls the other charity, two or more charities are under common control or control that links many charities. <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/chapter-8-the-gift-aid-small-donations-scheme#community-buildings> (Date of use: 1 December 2019).

⁴³⁵ <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/chapter-8-the-gift-aid-small-donations-scheme#community-buildings> (Date of use: 1 December 2019).
⁴³⁶ Section 189 of the CTA.

⁴³⁷ Section 190(1) CTA Chapter 4 explains the term "qualifying charitable donations" to mean
(a) payments which are qualifying payments for Chapter 2 (certain payments to a charity) and
(b) amounts treated as qualifying charitable donations under Chapter 3 (certain disposals of investments to charity).

⁴³⁸ Section 189(1) of the CTA.

⁴³⁹ Section 189(2) of the CTA.

The amount that reduces the company's taxable profits for the period to nil is limited to the amount of the deduction.⁴⁴⁰ A deduction is only allowed under qualifying donations from a company during a specific accounting period.⁴⁴¹ Section 189(5) states that

the above provisions are subject to Chapter 2A of this Part, section 939F and to any other express exceptions in the Corporation Tax Act 2010".

If a company makes a payment to a charity, such payment is deductible only if the conditions, set out in section 191 of the CTA, are met.⁴⁴² Kessler⁴⁴³ provides explanations for the benefit rule and the distribution rule. According to Kessler, the benefit rule is very similar to that of individual Gift Aid, except that the rule refers to benefits received from associated persons when companies use it. The rule has a broader meaning than connected persons as used in terms of individual Gift Aid.

A second difference is that individual Gift Aid requires there to be a gift, which is not a requirement in terms of corporate Gift Aid.⁴⁴⁴ In terms of the distribution rule, more accurately referred to in the CTA as "Condition E",⁴⁴⁵ Kessler highlights that when determining if a company's payment to a charity is a distribution or not, one must look at the meaning of the word distribution in terms of part 23 of CTA 2010.

Section 1000(1) of the CTA 2019 describes the word "distribution" as

... any dividend paid by the company, including a capital dividend or any other distribution out of assets of the company in respect of the shares in the company, except however much (if any) of the distribution (a) represents repayment of capital shares, or (b) is (when it is made) equal to the amount or

⁴⁴⁰ Section 189(3) of the CTA.

⁴⁴¹ Section 189(4) of the CTA.

⁴⁴² The conditions for a qualifying payment by a company to a charity are set out in section 191 of the CTA as

Condition A is that the payment is a payment of a sum of money, or Condition B is that payment is not subject to a condition as to repayment (but read with section 192), or Condition C is that the company making the payment is not itself a charity, or Condition D is that the payment is not disqualified under section 193 (associated acquisition etc. by a charity) or Condition E is that the payment is not disqualified under section 194 (certain distributions) or Condition F is that the payment is not disqualified under section 195 (associated benefits).

⁴⁴³ Kessler, Wong and Birkbeck *Taxation of Charities and Non-Profit Organisations*. https://www.taxationofcharities.co.uk/index.php/Corporate_Gift_Aid (Date of use: 23 December 2019).

⁴⁴⁴ Kessler, Wong and Birkbeck *Taxation of Charities and Non-Profit Organisations*. https://www.taxationofcharities.co.uk/index.php/Corporate_Gift_Aid (Date of use: 23 December 2019).

⁴⁴⁵ Section 191(6) of the CTA describes "Condition E" as "the payment that is not disqualified under section 194 (certain distributions) of the CTA".

value to any new consideration received by the company for the distribution
....⁴⁴⁶

According to Kessler, it is essential to determine if a gift is “in respect of shares”.
Section 1113(3) of the CTA explains that for the purposes of this Part,

a thing is regarded as done in respect of a share if it is done to a person (a) as the holder of the share, or (b) as the person who held the share at a particular time.

Section 1113(4) states:

For the purposes of this Part a thing is also regarded as done in respect of a share if it is done in pursuance of a right granted or an offer made, in respect of a share.⁴⁴⁷

In *Noved Investment v HMRC* [2006] STC (SCD) 120 the court held that a gift by a trading company to a charity is by definition inclusive and not exclusive. HMRC is of the view that

whether a payment made by a company to a charity is a distribution in respect of shares is a question of fact. It should be noted that a “distribution in respect of shares” has a wider meaning than “dividend”. Broadly, any payment made by a company to a charity in its capacity as shareholder is regarded as a distribution in respect of shares in a company, and as such will not qualify as a Gift Aid donation.⁴⁴⁸

3.7 Conclusion

Charities enjoy preferential tax treatment in England and Wales provided that the charity uses its income to fulfil the charitable purpose of a charity. Sections 466 – 493 of the CTA 2010 outlines the preferential tax treatment of charitable companies and sections 521 – 536 of the ITA 2007 explains how charitable trusts can enjoy such preferential treatment. Charities that carry on trading activities integrate such activities into their charitable activities or to raise funds. There are different tax implications for direct (Income Tax and Corporation Tax) taxes which charities must know. Charities enjoy tax preferential tax treatment of direct taxes when trading is carried on in terms of charitable trading and not for non-charitable trading.

⁴⁴⁶ Section 1000 of the CTA.

⁴⁴⁷ Section 1113(4) of the CTA.

⁴⁴⁸ <https://www.gov.uk/guidance/tax-relief-on-gifts-of-land-buildings-or-shares#a-gift-of-shares>
(Date of use: 2 December 2019).

Charities can enjoy preferential tax treatment in terms of income or corporation tax from the profits generated from trading activities provided that such charities can satisfy at least one out of three identified conditions. These categories are that the charity's trade qualifies as charitable trade, or the non-charitable trading turnover does not exceed the prescribed threshold, or that the trading activity qualifies to be a VAT-exempt fundraising event.

In the absence of satisfying at least one of these conditions, the charity will be charged with paying income or corporation tax levies on such trading activity. HMRC has a detailed guide that sets out the basic principles with which charities implements trading and business activities.⁴⁴⁹ Individuals and corporates who donate to charities and who fulfil the requirements in terms of tax legislation may claim back 25p for every £1 donated to a charity. The form of tax charge referred to is Gift Aid. Charities enjoy preferential tax treatment in terms of Capital Gains Tax provided that they adhere to the requirements outlined in the tax laws as discussed earlier in this chapter.

The next chapter will draw a comparison between the tax implications for a PBO in South Africa that carries on trading activities to supplement its income and a charity operating in the England and Wales, as well as the similarities and differences of PBOs and charities.

⁴⁴⁹ <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-iv-trading-and-business-activities-basic-principles> (Date of use: 5 December 2019).

CHAPTER 4

SIMILARITIES AND DIFFERENCES OF PUBLIC BENEFIT ORGANISATIONS AND CHARITIES

4.1 Introduction

The South African government recognises the important role of the not-for-profit sector to help address the socio-economic challenges faced by its citizens.⁴⁵⁰ The responsibility to address the socio-economic challenges of its citizens usually falls on the government in a country, but it is generally unable to perform all these services.

Most developed and underdeveloped countries grant preferential tax treatment to the non-profit sector to relieve the economic burden of the nonprofitmaking sector to meet the growing demand of providing much needed services to the poorest of the poor.⁴⁵¹ No South African or England and Wales organisation receives automatic preferential tax treatment. There are specific criteria set out in terms of tax legislation in each country that an organisation must meet before it can enjoy preferential tax treatment.⁴⁵²

In South Africa and in England and Wales, the services provided to the public must be for the benefit of the public, and not individuals, before the organisation will be approved or recognised as a Public Benefit Organisation (PBO)⁴⁵³ or charity.⁴⁵⁴ In England and Wales, all organisations that generate an annual income of £5 000 and more or any Charitable Incorporated Organisation (CIO), must register with the Charity Commission.⁴⁵⁵ In contrast, in South Africa, no such restriction exists for

⁴⁵⁰ <https://www.sars.gov.za/ClientSegments/Businesses/TEO/Pages/default.aspx> (Date of use: 13 April 2020).

⁴⁵¹ Katz *et al* (1999) Ninth Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa 2.

⁴⁵² Section 30 and section 10(1)(cN) of the Act for a South African organisation and in England and Wales sections 521 – 536 of the Income Tax Act 2007 and sections 466 – 493 of the Corporation Tax Act 2010.

⁴⁵³ Section 30 of the Act.

⁴⁵⁴ Section 1 of Part 1 of the Charities Act 2011.

⁴⁵⁵ <https://www.gov.uk/setting-up-charity/register-your-charity> (Date of use: 13 April 2020).

organisations operating in the non-profit sector.⁴⁵⁶ South Africa, England and Wales recognise four specific legal entities when seeking approval for preferential tax treatment. The types of legal entities, however, differ between South Africa⁴⁵⁷ and that of England and Wales.⁴⁵⁸ South African income tax legislation makes provision only for approved PBOs to make an application for preferential tax treatment in terms of section 10(1)(cN).⁴⁵⁹ The income tax legislation applicable to England and Wales requires an organisation to be registered as a charity with the Charity Commission and apply to Her Majesty's Revenue and Customs (HMRC) before it can enjoy preferential tax treatment.⁴⁶⁰ This requirement is similar in South Africa but with the difference that England and Wales require institutions to register as a charity which is regulated under a different statute called the Charities Act 2011. PBOs fall under the Income Tax Act 58 of 1962 and is not regulated separately from the said Act.⁴⁶¹

South Africa, England and Wales have conditions and requirements stipulated in the respective income tax legislation when a PBO or charity receives income from any business undertaking or trading activity. South African income tax legislation provides for four way in which are explained in section 10(cN)(ii)(aa) - (dd) of the Income Tax Act 58 of 1962 that the income that a PBO receives from a business undertaking or trading activity qualifies to enjoy preferential tax treatment.⁴⁶² In contrast, in England and Wales, organisations registered as charities must meet two conditions that are outlined by the Income Tax Act 2007⁴⁶³ and charitable companies must meet three conditions that are outlined in the Corporations Tax Act 2010.⁴⁶⁴

Chapter four of this research paper will critically analyse the similarities and differences between an approved South African PBO and a charity in England and

⁴⁵⁶ Section 12(1) of the Nonprofit Organisations Act 71 of 1997.

⁴⁵⁷ Section 30 of the Act.

⁴⁵⁸ <https://www.gov.uk/guidance/charity-types-how-to-choose-a-structure> (Date of use: 13 April 2020).

⁴⁵⁹ Section 10(1)(cN) of the Act.

⁴⁶⁰ <https://www.gov.uk/charities-and-tax/get-recognition> (Date of use: 13 April 2020).

⁴⁶¹ Section 30 read with section 10(1)(cN) of the Act.

⁴⁶² Section 10(1)(cN)(aa) – (dd) of the Act.

⁴⁶³ Section 524(3)-(4) of the Income Tax Act 2007.

⁴⁶⁴ Section 478 of the Corporations Tax Act 2010.

Wales. It will furthermore compare the scope of such organisations contained in the provisions of the income tax legislation of South Africa and England and Wales, when receiving income from any business undertaking or trading activity.

4.2 Critical analysis of the similarities and differences of PBOs in South Africa and charities in England and Wales

The registration of an organisation is voluntarily and not a requirement to operate as a Nonprofit Organisation (NPO) in South Africa.⁴⁶⁵ There is no single body that oversees or regulates the operations of the South African non-profit sector. The organisations in South Africa may take the form and operate as a Voluntary Association or a registered NPO or Trust or a Nonprofit Company (NPC).

In South Africa, only an approved PBO can apply to the Tax Exemption Unit (TEU) at the South African Revenue Service (SARS) for preferential tax treatment. The TEU is a specific unit in SARS that deals with such applications and ensures that an approved PBO complies with the legislative framework operating in South Africa.⁴⁶⁶ The TEU examines and approves a PBO that qualifies for preferential tax treatment under the provisions of sections 10(1)(cN) and 18A of the Income Tax Act in South Africa.⁴⁶⁷ All approved PBOs in South Africa must submit an annual income tax return on the IT12EI form which is available online on the SARS website.

In contrast with South Africa, England and Wales require all charitable organisations with a yearly income of £5 000 plus or that is registered as a Charitable Incorporated Organisation (CIO) to register with the Charity Commission. The Charities Act 2011 established the Charity Commission, which functions independently from any Minister of the Crown or any government department in England and Wales.⁴⁶⁸ The Charity Commission must, however, function within the legislative framework⁴⁶⁹ and the administrative controls of the Treasury.⁴⁷⁰ Once registered as a charity with the

⁴⁶⁵ Section 12(1) of the Nonprofit Organisations Act 71 of 1997.

⁴⁶⁶ <https://www.sars.gov.za/ClientSegments/Businesses/TEO/Pages/default.aspx> (Date of use: 24 August 2020).

⁴⁶⁷ <https://www.sars.gov.za/ClientSegments/Businesses/TEO/Pages/default.aspx> (Date of use: 14 April 2020).

⁴⁶⁸ Sections 13(3) and 13(4) of Part 2 of the Charities Act 2011.

⁴⁶⁹ Section 13(5)(a) of Part 2 of the Charities Act 2011.

⁴⁷⁰ Section 13(5)(b) of Part 2 of the Charities Act 2011.

Charity Commission, the charity can apply to HMRC for recognition of preferential tax treatment, provided that it meets the four requirements set out by HMRC and discussed in detail in chapter three above.⁴⁷¹

In South Africa, SARS approves PBOs that must comply with the conditions and requirements set out in sections 30 and 10(1)(cN) of the Act to be eligible for preferential tax treatment in terms of income and capital gains.⁴⁷² HMRC does not disregard the income tax and gains liability of an institution in England and Wales unless such an institution is a registered charity in terms of the Charities Act 2011.⁴⁷³

SARS recognises a Nonprofit Company (NPC) or trust or an association of persons or any foreign branch of an association, trust, or company, incorporated or formed in any other country that is exempted from tax, to qualify for approval as a PBO. HMRC recognises any charitable company or charitable incorporated organisation or charitable trust or unincorporated charitable association to qualify for preferential tax treatment in England and Wales. In contrast to South Africa, HMRC does not recognise a foreign branch of an association, trust, or company, incorporated or formed outside the UK, except in the European Union, Iceland, Liechtenstein or Norway to qualify for registration as a charity in these countries.

A registered NPC that is also an approved PBO in South Africa enjoys preferential tax treatment in terms of section 10(1)(cN) of the Act and will not be charged the same tax levies as for-profit companies. A company that is registered as a “charitable company”⁴⁷⁴ in England and Wales is exempt from paying a corporations tax levy on its total income from the profit from its trading activities of the said company complies with the requirements in sections 478 and 479 of the Corporations Tax Act 2010.⁴⁷⁵ South Africa, in contrast to England and Wales,

⁴⁷¹ HMRC Guidance Chapter 2: Applications for recognition as a charity for tax purposes 4 May 2021 paragraph 2. <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/chapter-2-applications-for-recognition-as-a-charity-for-tax-purposes> (Date of use: 11 October 2021).

⁴⁷² Sections 30 and 10(1)(cN) of the Act.

⁴⁷³ Paragraph 27 of Schedule 6 to the Finance Act 2010.

⁴⁷⁴ Section 193 of the Charities Act 2011.

⁴⁷⁵ Sections 478 and 479 of the Corporations Tax Act 2010.

provides preferential tax treatment under the Act for all approved PBOs irrespective of the type of legal entity.

In South Africa, the primary object of the legal entity must be for a public purpose and to implement at least one public benefit activity included on the list of eleven categories in Part I of the Ninth Schedule to the Act.⁴⁷⁶ A public benefit activity must fall into one of the categories of welfare and humanitarian,⁴⁷⁷ health care,⁴⁷⁸ land and housing,⁴⁷⁹ education and development,⁴⁸⁰ religion, belief or philosophy,⁴⁸¹ cultural,⁴⁸² conservation, environment and animal welfare,⁴⁸³ research and consumer rights,⁴⁸⁴ sport,⁴⁸⁵ providing of funds,⁴⁸⁶ assets or other resources and general.⁴⁸⁷

Section 30 of the Act states that a public benefit activity must not intend to make a profit and it must not advance the pecuniary self-interest of any fiduciary or employee of the organisation besides that that is provided for in terms of reasonable remuneration for such fiduciary or employee. SARS will refuse approval to an organisation or NPC as a PBO on the basis that its founding document i.e., constitution, will or other written instrument does not have a minimum of “three persons that are not connected in relation to each other” to assume the “fiduciary responsibility” of the organisation or NPC.⁴⁸⁸

The Charities Act applicable in England and Wales, like the South African Income Tax Act, requires an organisation or company to be established for a charitable purpose and to the benefit of the public to qualify as a charity. There are thirteen categories listed as a charitable purpose in section 3(1) of the Charities Act 2011

⁴⁷⁶ Section 30 of the Act.

⁴⁷⁷ Paragraph 1(a)-(q) of Part I of the Ninth Schedule to the Act.

⁴⁷⁸ Paragraph 2(a)-(f) of Part I of the Ninth Schedule to the Act.

⁴⁷⁹ Paragraph 3(a)-(h) of Part I of the Ninth Schedule to the Act.

⁴⁸⁰ Paragraph 4(a)-(r) of Part I of the Ninth Schedule to the Act.

⁴⁸¹ Paragraph 5(a)-(c) of Part I of the Ninth Schedule to the Act.

⁴⁸² Paragraph 6(a)-(c) of Part I of the Ninth Schedule to the Act.

⁴⁸³ Paragraph 7(a)-(d) of Part I of the Ninth Schedule to the Act.

⁴⁸⁴ Paragraph 8(a)-(b) of Part I of the Ninth Schedule to the Act.

⁴⁸⁵ Paragraph 9 of Part I of the Ninth Schedule to the Act.

⁴⁸⁶ Paragraph 10(a)-(d) of Part I of the Ninth Schedule to the Act.

⁴⁸⁷ Paragraph 11(a)-(d) of Part I of the Ninth Schedule to the Act.

⁴⁸⁸ Section 30(3)(b)(i) of the Act.

which is comparable to the list provided in Part 1 of the Ninth Schedule to the Act in South Africa. The list of charitable purposes in England and Wales includes a specific category for the “prevention of the relief of poverty”⁴⁸⁹, the “advancement of arts, culture, heritage or science”⁴⁹⁰ and the “advancement of citizenship and community development”^{491, 492}. The difference when comparing the countries with the description of public benefit activities is that the South African Income Tax Act provides broad categories and it specifies clearly what type of public benefit activities would qualify under each category.⁴⁹³ The Charities Act for England and Wales does not provide clarity on what qualifies a public benefit activity to fall in the category of “the prevention of the relief of poverty” for example. The list of descriptions on what activities qualify as public benefit activities for the purpose of enjoying preferential tax treatment on income tax levies is clear and specific in terms of South African income tax legislation.

The South African list of public benefit activities does not include a primary category such as the relief of poverty or community development, but as paragraphs within the categories of welfare and humanitarian.⁴⁹⁴ The welfare and humanitarian category includes the promotion of community-based projects relating to self-help and assistance to emerging micro-enterprises as sub-paragraphs.⁴⁹⁵

The South African income tax laws include a second list⁴⁹⁶ that provides a restrictive list of five categories within which a public benefit activity must fall before a PBO can issue its donors with a tax-deductible certificate in respect of a *bona fide* donation⁴⁹⁷ made in cash or in kind to the PBO.⁴⁹⁸ An approved PBO can qualify for preferential tax treatment in terms of section 10(1)(cN)⁴⁹⁹ in South Africa but is

⁴⁸⁹ Section 3(1)(a) of the Charities Act 2011.

⁴⁹⁰ Section 3(1)(f) of the Charities Act 2011.

⁴⁹¹ Section 3(1)(e) of the Charities Act 2011.

⁴⁹² Sections 3(1)(a) and 3(1)(e) of the Charities Act 2011.

⁴⁹³ Part I and Part II of the Ninth Schedule to the Act.

⁴⁹⁴ Part I of the Ninth Schedule to the Act.

⁴⁹⁵ Paragraph 1(p)(i) and 1(p)(iii) of Part I of the Ninth Schedule to the Act.

⁴⁹⁶ Part II of the Ninth Schedule to the Act.

⁴⁹⁷ The term “donation” is defined in section 55(1) of the Act.

⁴⁹⁸ Part II of the Ninth Schedule to the Act includes welfare and humanitarian, health care, education and development, conservation, environment and animal welfare and that of land and housing as the categories that qualify for the issuing of a section 18A tax-deductible certificate.

⁴⁹⁹ Section 10(1)(cN) of the Act.

prohibited from issuing a tax-deductible certificate to its donors if the public benefit activity is not one listed in Part II of the Ninth Schedule to the Act.

The categories contained in Part II of the Ninth Schedule⁵⁰⁰ excludes six categories in Part I.⁵⁰¹ Public benefit activities that fall into the categories of religion, sport, and culture⁵⁰² are excluded from Part II. The nonprofitmaking sector criticises the government's decision to exclude⁵⁰³ six of the eleven categories from the list in Part II of the Ninth Schedule to the Act.⁵⁰⁴

The non-profit sector argues that the omission of cultural activities, a category that includes youth development, from Part II of the Ninth Schedule to the Act is detrimental to the country's attempt to address the growing number of unemployed youth in South Africa.⁵⁰⁵ The Davis Committee recommended that SARS must revise the exclusions from Part II of the Ninth Schedule to the Act, which will result in inclusion and exclusion that is more beneficial to the needs of South Africa.⁵⁰⁶

An individual qualifies for income tax relief under Gift Aid⁵⁰⁷ and as described in section 412(2) of the Income Tax Act 2007 when the person donates a gift to a charity provided that such a gift is regarded as "qualifying donation"^{508, 509}. The HMRC guidance clarifies that the donation from an individual though through Gift Aid will qualify if such a donation does not exceed four times of what the person paid in income tax or gains tax during the year of assessment.⁵¹⁰ Section 472(1) of the Corporations Tax Act 2010 explains that where a charitable company receives a "qualifying donation"⁵¹¹ as a gift from an individual, the total amount of the gift

⁵⁰⁰ Part II of the Ninth Schedule to the Act.

⁵⁰¹ Part I of the Ninth Schedule to the Act.

⁵⁰² Paragraphs 5, 6 and 9 of Part I of the Ninth Schedule to the Act.

⁵⁰³ Davis Tax Committee: Public Benefit Organisations Report: March 2018 6.

⁵⁰⁴ Part II of the Ninth Schedule to the Act excludes religion, belief and philosophy, cultural, research and consumer rights, sport, provision of funds, assets or resources and general activities from the list of activities that qualify for the issuing of section 18A tax-deductible certificates.

⁵⁰⁵ Davis Tax Committee: Public Benefit Organisations Report: March 2018 6.

⁵⁰⁶ Davis Tax Committee: Public Benefit Organisations Report: March 2018 22-24.

⁵⁰⁷ The rate of gift aid relief is at 25p for every £1 donated.

⁵⁰⁸ Section 416(7) of the Income Tax Act 2007.

⁵⁰⁹ Section 414(1) of the Income Tax Act 2007.

⁵¹⁰ <https://www.gov.uk/donating-to-charity/gift-aid> (Date of use: 21 November 2022).

⁵¹¹ Part 8 of the Income Tax Act 2007.

added to the company's calculation of corporation tax.⁵¹² However, section 472(2) further explains that the company must exclude to sum total of the gift that was used for "charitable purposes" from the said company's total profits in its calculation to determine what amount is payable in terms of corporations tax.⁵¹³ Section 472(4) of the Corporations Tax Act 2010 requires the charitable company to claim the exemption provided for in section 472(2).⁵¹⁴ HMRC requires anyone who wants to claim income tax relief through Gift Aid to complete a Gift Aid declaration⁵¹⁵ for each charity that it donates a "qualifying donation".⁵¹⁶ A Gift Aid declaration is different to section 18A tax-deductible certificate in South Africa. Tax relief is only allowed if a qualifying donation⁵¹⁷ is made to a legal entity that is approved or recognised by the tax authority in the country.⁵¹⁸ No tax relief is allowed in South Africa or in England and Wales if the donation or gift benefits the donor.⁵¹⁹

The difference between an approved section 18A(1) PBO in South Africa and a recognised charity in England and Wales is that in England and Wales the charity receives a cash donation from an individual⁵²⁰ and a corporate,⁵²¹ and it can also claim Gift Aid from the same cash donation made during the year of assessment. Both the donor and the recognised charity can claim Gift Aid from HMRC, but in South Africa, the tax relief benefit is at the hand of the donor and not the PBO. Section 18A of the Income Tax Act 58 of 1962 states that a South African taxpayer may only deduct 10% of the total donation made to an approved section 18A PBO in any year of the tax assessment.⁵²² If the said donation exceeds the allowed limit of 10% the excess amount may be included as a deduction in the taxpayer's year of tax assessment for the following year with the same limitation of not exceeding 10%.⁵²³ Section 18A does not allow for an approved PBO under the said section to

⁵¹² Section 472(1) of the Corporations Tax Act 2010.

⁵¹³ Section 472(2) of the Corporations Tax Act 2010.

⁵¹⁴ Section 472(4) of the Corporations Tax Act 2010.

⁵¹⁵ Section 428 of the Income Tax Act 2007.

⁵¹⁶ <https://www.legislation.gov.uk/ukpga/2007/3/part/8/chapter/2> (Date of use: 21 November 2022).

⁵¹⁷ Section 416(1) of the Income Tax Act 2007.

⁵¹⁸ Section 18A of the Act and section 414 of the Income Tax Act 2007.

⁵¹⁹ Section 417 of the Income Tax Act 2007.

⁵²⁰ Section 414(1) of the Income Tax Act 2007.

⁵²¹ Section 189 of the Corporation Tax Act 2010.

⁵²² Section 18A of the Income Tax Act 58 of 1962.

⁵²³ Section 18A of the Act.

claim an amount from SARS on top of the donation received from the donor. In England and Wales, a donor can claim Gift Aid for small cash donations or contactless card donations that are less than £30 on or after 6 April 2019.⁵²⁴

HMRC restricts the amount that a donor can claim under the Gift Aid Small Donations Scheme (GASDS) which may not exceed more than ten times the amount of Gift Aid claimed.⁵²⁵ The South African income tax laws do not include a scheme similar to GASDS in England and Wales. However, the section 18A of the Income Tax Act 58 of 1962 limits the percentage that an individual donor or company can claim in respect of a *bona fide* donation made to a PBO to not exceed 10%⁵²⁶ of the taxable income in a specific tax year.⁵²⁷ If the donation made exceeds the 10% limitation, the difference may be rolled over to the following years of taxation on condition that the donation is not more than 10% of the total dutiable income for any given year of assessment.⁵²⁸ Gift Aid in the England and Wales is only applicable to a cash donation made to a charity,⁵²⁹ but in South Africa, the section 18A tax-deductible certificate can be issued for a cash donation or a donation in kind made to an approved PBO.⁵³⁰

4.3 Critical analysis of the trading activities of public benefit organisations in South Africa and charities in England and Wales

The South African income tax legislation makes provision for an approved PBO to conduct a business undertaking or perform a trading activity without losing its preferential tax treatment.⁵³¹ Section 10(1)(cN)(i) of the Income Tax Act 58 of 1962 explains when the income that a PBO receives from a business undertaking or trading activity qualifies to be exempt from paying the normal income tax levy.⁵³² The said conditions under section 10(1)(cN) was discussed in detail in Chapter 3 of

⁵²⁴ <https://www.gov.uk/claim-gift-aid/small-donations-scheme> (Date of use: 10 May 2020).

⁵²⁵ <https://www.gov.uk/claim-gift-aid/small-donations-scheme> (Date of use: 10 May 2020).

⁵²⁶ Section 18A(1)(B) of the Act was amended by section 18 of the Taxation Laws Amendment Act 8 of 2007.

⁵²⁷ Section 18A(1)(B) of the Act.

⁵²⁸ The proviso to section 18A(1)(B) was inserted by section 52(1)(c) of the Taxation Laws Amendment Act 31 of 2013.

⁵²⁹ Section 416(2) of the Income Tax Act 2007.

⁵³⁰ Section 18A of the Act.

⁵³¹ Section 10(1)(cN)(ii)(aa) – (dd) of the Act.

⁵³² Section 10(1)(cN)(ii) of the Act.

this research paper. The income tax legislation in England and Wales sets out two conditions for recognised charities to enjoy preferential tax treatment when engaging in any trading activity.⁵³³

A recognised charitable company in England and Wales that undertakes a trading activity must meet three conditions before it enjoys preferential tax treatment.⁵³⁴ In South Africa an NPC must be approved as a PBO to qualify for preferential income tax treatment under the Income Tax Act 58 of 1962.⁵³⁵ The income that a PBO generates from any business undertaking or trading activity must satisfy the conditions in section 10(1)(cN)(ii) of the Income Tax Act 58 of 1962 for such income to be exempt from the normal income tax levy payable by the PBO.⁵³⁶ The South African income tax legislation sets out specific conditions for business undertakings or trading activities performed as an integral part of the activities of the PBO,⁵³⁷ similar to the conditions set out for charities in the income tax legislation of the England and Wales.⁵³⁸

A comparable condition in South Africa and England and Wales is that an approved PBO in South Africa, and a recognised charity or a registered charitable company in England and Wales must carry on a business undertaking or trading activity to implement the sole or principal object or primary purpose of the PBO or charity to enjoy preferential tax treatment in the respective countries.⁵³⁹ The income tax legislation applicable in England and Wales also allows preferential tax treatment to a charity if the beneficiaries of a charity carry out the trading activity⁵⁴⁰ and the profit or accrual from a non-primary purpose trade does not exceed the prescribed limit.⁵⁴¹

⁵³³ Section 524(3)-(4) of the Income Tax Act 2007.

⁵³⁴ Section 478 of the Corporations Tax Act 2010.

⁵³⁵ Section 30 of the Act.

⁵³⁶ Section 10(1)(cN) of the Act.

⁵³⁷ Section 10(1)(cN)(ii)(aa) of the Act.

⁵³⁸ Section 524(3)-(4) of the Income Tax Act 2007.

⁵³⁹ Section 10(1)(cN)(ii)(aa) of the South African Act and section 524(1)-(2) of the Income Tax Act 2007 for England and Wales.

⁵⁴⁰ <https://www.gov.uk/guidance/charities-and-trading#subsidiary-trading> (Date of use: 24 May 2020).

⁵⁴¹ Sections 524 and 525 of the Income Tax Act 2007 and sections 478 and 479 of the Corporation Tax Act 2010.

The prescribed limits are £8 000 permitted small trade for a charity with an annual gross income below £32 000 or 25% of the charity's turnover if the annual gross income exceeds £32 000, but below £320 000 per annum, or £80 000 if the charity's gross income is more than £320 000 per annum.⁵⁴² The South African income tax legislation limits the total receipts and accrual of a PBO deriving from any business undertaking or trading activity that does not fall in the scope under section 10(1)(cN)(ii)(aa)-(cc)⁵⁴³ to the greater of 5% or R200 000.⁵⁴⁴ One difference between the countries is that South Africa's income tax legislation cautions against the PBO performing a trading activity or business undertaking because it is concern that such an act may lead to in unfair competition with other dutiable entities.⁵⁴⁵

In contrast, the charities in England and Wales are encouraged to set up a subsidiary trading company if a charity envisaged any trading activity not linked to its primary purpose.⁵⁴⁶ No approved PBO, recognised charity or registered charitable company enjoys one hundred percent tax relief for any profits or accrual from the undertaking of a business or trading activity. The tax relief is only allowed for the activities that fulfil the conditions set out in the respective tax legislation. Any business undertaking or trading activity that a PBO, charity or charitable company performs that does not meet these conditions, will form part of the taxable income.⁵⁴⁷

When a group of volunteers organise an occasional fundraising event during which a business undertaking or trading activity takes place to generate income for a PBO to help implement its sole purpose, the income generated from such an undertaking or activity is exempt from paying an income tax levy.⁵⁴⁸ The income tax legislation in South Africa allows a PBO to exclude the income received from the receipts and accruals generated from a fundraising event from the total income tax calculation

⁵⁴² <https://www.gov.uk/guidance/charities-and-trading#subsidiary-trading> (Date of use: 24 May 2020).

⁵⁴³ Section 10(1)(cN)(ii)(aa)-(cc) of the Act.

⁵⁴⁴ Section 10(1)(cN)(dd) of the Act.

⁵⁴⁵ Section 10(1)(cN)(aa)(C) of the Act.

⁵⁴⁶ <https://www.gov.uk/guidance/charities-and-trading#subsidiary-trading> (Date of use: 24 May 2020).

⁵⁴⁷ Section 10(1)(cN) of the Act, section 416 of the Income Tax Act 2007 and section 479 of the Corporation Tax Act 2010.

⁵⁴⁸ Section 10(1)(cN)(ii)(bb) of the Act.

due in a specific tax year of assessment.⁵⁴⁹ In *CIR v The Witwatersrand Association of Racing Clubs* 1960 3 SA 291 (A), 23 SATC 380 the court stated that the taxpayer was liable to pay the income tax levy on the proceeds of a fundraiser that it organised on behalf of two benefitting charities. The taxpayer in this case held a race meeting fundraiser in its own name and it received the proceeds in its own bank account. The court held that because the proceeds were not paid over to the charities immediately when it was received from the donors, it must form part of the taxpayer's annual income which makes it liable for a tax levy in terms of income tax. It is important that when funds are raised from fundraising events, the income received must form part of the PBO and not a private person or entity for such income to be exempted from a tax levy charge.

Section 10(1)(cN)(ii)(bb)⁵⁵⁰ requires unpaid volunteers to assist with the fundraising event before it enjoys preferential tax treatment in South Africa.⁵⁵¹ A charity enjoys preferential tax treatment of the income generated from a fundraising activity if such activity complies with the requirements outlined in section 529 of the Income Tax Act or section 483 of the Corporations Tax Act in England and Wales.⁵⁵² If a PBO operates a conference centre and pays members from a poor community monthly to financially support the implementation of one or more public benefit activities, such business undertaking or trading activity results in unfair competition with commercial entities.⁵⁵³ The PBO must pay the required income tax levy on the total profit received from the trading activity or business undertaking in a specific tax year.

Like South Africa, the income tax legislation in England and Wales requires the trading activity of a charity to qualify as a charitable trade, and that it is mainly the beneficiaries of the charity who conduct the trading activity without remuneration.⁵⁵⁴ The fact that a charity conducts a once-off trading activity to augment its income

⁵⁴⁹ Section 10(1)(cN)(ii)(bb) of the Act.

⁵⁵⁰ Section 10(1)(cN)(ii)(bb) of the Act.

⁵⁵¹ Section 10(1)(cN)(ii)(bb) of the Act.

⁵⁵² Section 529 of the Income Tax Act 2007 and Section 483 of the Corporation Tax Act 2010 requires the profit from a fundraising activity to be VAT exempt, used for the charitable purposes of the charity or for the profit made to be transferred to another charity.

⁵⁵³ Section 10(1)(cN)(ii)(aa)(C) of the Act.

⁵⁵⁴ Section 525(1)(a) and (b) of the Income Tax Act 2007 and Section 479(1)(a) and (b) of the Corporation Tax Act 2010 for England and Wales.

does not grant such trading activity automatic preferential tax treatment in England and Wales unless the trading activity complies to the conditions outlined in the income tax legislation.⁵⁵⁵

Like a PBO in South Africa, a charity operating in England and Wales must use the profit generated from a trading activity solely to implement its charitable purpose to qualify for preferential tax treatment included in the income tax legislation in these countries.⁵⁵⁶ The trading activity of a charity must satisfy at least one of three conditions before it enjoys preferential tax treatment in England and Wales.⁵⁵⁷ Similar to the allowable limit on a PBO carrying on a business undertaking or trading activity in South Africa⁵⁵⁸, the income legislation in England and Wales also allows a charity to enjoy preferential tax treatment of a non-charitable trade conducted only if such activity falls below the threshold⁵⁵⁹ set annually by HMRC.⁵⁶⁰ If a charity sets up a charity shop in England and Wales to sell donated items and generates a profit that is solely used to carry on its charitable purpose, the receipts and accruals from the trading activity enjoy preferential tax treatment.⁵⁶¹ HMRC in England and Wales believes that the manner in which the charity shop acquired the items that it sells on behalf of the charity disconnects it from being a commercial activity.⁵⁶² The income tax legislation in both South Africa and England and Wales prohibits a PBO or a charity from a trading activity or business undertaking that unlocks unfair competition with commercial entities that conduct a similar trading activity.⁵⁶³

555 <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-iv-trading-and-business-activities-basic-principles> (Date of use: 18 June 2020).

556 Section 524 of the Income Tax Act 2007.

557 <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-iv-trading-and-business-activities-basic-principles> (Date of use: 17 June 2020).

558 Section 10(1)(cN)(ii)(dd)

559 Section 482(6) of the Corporation Tax Act 2010.

560 <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-iv-trading-and-business-activities-basic-principles> (Date of use: 21 June 2020).

561 <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-iv-trading-and-business-activities-basic-principles> (Date of use: 21 June 2020).

562 <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-iv-trading-and-business-activities-basic-principles> (Date of use: 21 June 2020).

563 <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-iv-trading-and-business-activities-basic-principles> (Date of use: 21 June 2020) and section 10(1)(cN)(ii)(aa)(C) of the Act.

A charity in England and Wales that conducts large scale trading activities can establish a subsidiary company⁵⁶⁴ to trade on behalf of the charity. The subsidiary company is still legally responsible to pay corporations tax but the payments made to its parent charity reduce the taxable profit.⁵⁶⁵ A monetary gift given to a charitable trust or a charitable company and used by such charitable trust or charitable company to implement its charitable purpose is omitted from the calculation of its total profits generated for the tax year in England and Wales.⁵⁶⁶ The total amount that a subsidiary company donates to its parent charity must not exceed the total profit available for distribution in a specific tax year.⁵⁶⁷

In South Africa, a PBO that is registered as a NPC⁵⁶⁸ may acquire and hold securities in a for-profit company on condition that the entire income from the securities are used to implement its public benefit object.⁵⁶⁹ A PBO that holds securities in a for-profit company may not merge with or convert to a for-profit company.⁵⁷⁰ If a PBO holds shares in a for-profit company and such company declares a dividend in a specific tax year, the PBO as the beneficial owner⁵⁷¹ of the dividend will not pay any dividends tax.⁵⁷² The PBO must submit a written declaration to the for-profit company that declared and paid the dividend or its regulated intermediary⁵⁷³ that paid the dividend to the PBO before this PBO, as the beneficial owner of the shares, can qualify for preferential tax treatment in terms of dividends tax levied.⁵⁷⁴ The income tax legislation in South Africa requires a PBO

⁵⁶⁴ Section 398 of the Corporation Tax Act 2010.

⁵⁶⁵ <https://www.gov.uk/government/publications/trustees-trading-and-tax-how-charities-may-lawfully-trade-cc35/trustees-trading-and-tax-how-charities-may-lawfully-trade#charities-with-trading-subsidiaries> (Date of use: 21 June 2020).

⁵⁶⁶ Section 522 of the Income Tax Act 2007 and section 473 of the Corporation Tax Act 2010.

⁵⁶⁷ <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-iv-trading-and-business-activities-basic-principles> (Date of use: 28 June 2020).

⁵⁶⁸ Section 1 of the Companies Act 71 of 2008.

⁵⁶⁹ Paragraphs 1(1)(a)(i) and (1)(2) of Schedule 1 to the Companies Act 71 of 2008.

⁵⁷⁰ Paragraph 2(1)(a) of Schedule 1 to the Companies Act 71 of 2008.

⁵⁷¹ Section 64D of the Act, as amended, describes the term “beneficiary owner” to mean the person entitled to the benefit of the dividend attaching to a share.

⁵⁷² Section 64F(1)(c) and section 64FA(1)(a) of the South African Act.

⁵⁷³ Section 64D of the South African Act describes the term “regulated intermediary”. The SARS Tax Exemption Guide for Public Benefit Organisations <https://www.sars.gov.za/AllDocs/OpsDocsGuides/LAPD-IT-G26%20-%20Tax%20Exemption%20Guide%20for%20Public%20Benefit%20Organisations%20in%20South%20Africa.pdf> (Date of use: 28 June 2020) describes the term “regulated intermediary” to mean “an entity that temporarily holds a dividend paid by a company before it is paid over to the ultimate beneficial owner”.

⁵⁷⁴ Section 64F(1)(c) and section 64FA(1)(a) of the Act.

that holds shares in a for-profit company to submit a written undertaking to the said company or its regulated intermediary in the event that the PBO is not a beneficial owner of the shares or in the event of any changing circumstances affecting the preferential tax treatment in respect of dividends tax.⁵⁷⁵

A PBO that holds an investment in a vesting trust is a beneficial owner of the investment held and therefore qualifies for preferential tax treatment in terms of dividends tax levies payable.⁵⁷⁶ The PBO that receives the dividend is not responsible for paying dividend tax if it submits the required written declaration to the company or its regulated intermediary.⁵⁷⁷ If a PBO holds an investment in a discretionary trust such a PBO may be charged a dividends tax levy because the PBO is not a beneficial owner of the dividend unless the trustees who administers a discretionary trust exercise their discretion to distribute the dividend to the PBO.⁵⁷⁸

It is vital that a PBO understands the income tax implications when holding an investment in a vesting trust and holding an investment in a discretionary trust. The onus is on the PBO to submit the written prescribed declaration to the company or its regulated intermediary that declares or pays the dividend to the trust in which the PBO holds an investment to prevent the payment of a dividends tax charge.⁵⁷⁹

4.4 Conclusion

An approved PBO in South Africa must apply to SARS for preferential tax treatment in respect of its receipts and accruals accumulated in a specific tax year.⁵⁸⁰ In England and Wales, a charity must be recognised by HMRC before it qualifies for

⁵⁷⁵ Section 64G(2)(a) and section 64H(2)(a) of the Act.

⁵⁷⁶ <https://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-IT-G26%20-%20Tax%20Exemption%20Guide%20for%20Public%20Benefit%20Organisations%20in%20South%20Africa.pdf> 40 (Date of use: 28 June 2020).

⁵⁷⁷ <https://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-IT-G26%20-%20Tax%20Exemption%20Guide%20for%20Public%20Benefit%20Organisations%20in%20South%20Africa.pdf> 40 (Date of use: 28 June 2020).

⁵⁷⁸ <https://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-IT-G26%20-%20Tax%20Exemption%20Guide%20for%20Public%20Benefit%20Organisations%20in%20South%20Africa.pdf> 40 (Date of use: 28 June 2020).

⁵⁷⁹ <https://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-IT-G26%20-%20Tax%20Exemption%20Guide%20for%20Public%20Benefit%20Organisations%20in%20South%20Africa.pdf> 40 (Date of use: 28 June 2020).

⁵⁸⁰ Section 10(1)(cN) of the Act.

preferential tax treatment of its receipts and accruals in a specific tax year.⁵⁸¹ The Charity Commission for England and Wales requires any legal entity that earns a yearly income of £5 000 and above to register as a charity with the commission for England and Wales.⁵⁸² There is not a similar body to the Charity Commission for England and Wales to regulate the non-profit sector in South Africa. Each legal entity in South Africa is regulated and reports to a specific authority that is created under specific legislation in terms of which it is registered but it excludes voluntary associations that do not have any legislation under which it must register.⁵⁸³

A registered legal entity in South Africa or in England and Wales does not automatically qualify for preferential tax treatment but have to meet the prescribed requirements in the respective income tax legislation in each country.⁵⁸⁴ The income that a PBO in South Africa or a charity in England and Wales receives must be used to implement its primary object and for a public purpose before such income will be considered for preferential tax treatment.⁵⁸⁵

The receipts and accruals of a PBO will enjoy preferential tax treatment in South Africa if it carries on one of the listed public benefit activities in Part I of the Ninth Schedule to the income tax legislation.⁵⁸⁶ However, SARS will only approve a PBO to issue its donors with a section 18A tax-deductible certificate for a donation received if at least one of its objects falls under one of the listed categories included in Part II of the Ninth Schedule to the Act.⁵⁸⁷

⁵⁸¹ <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/chapter-2-applications-for-recognition-as-a-charity-for-tax-purposes> (Date of use: 28 June 2020).

⁵⁸² <https://www.gov.uk/setting-up-charity/register-your-charity?step-by-step-nav=3dd66b86-ce29-4f31-bfa2-a5a18b877f11> (Date of use: 29 June 2020).

⁵⁸³ An NPO is registered in terms of section 1 of the Nonprofit Organisations Act 71 of 1997 and all NPOs report to the Department of Social Development. A trust is registered in terms of section 1 of the Trust Property Control Act 57 of 1988 and falls under the office of the Master of the High Court. A nonprofit company is established in terms of section 1 of the Companies Act 71 of 1998 and adheres to the sections contained in the Companies Act.

⁵⁸⁴ The South African Income Tax Act sets out the conditions and requirements for organisations to qualify for preferential tax treatment in section 30 and section 10(1)(cN) of the Act. England and Wales require organisations to register as a charity in terms of the provisions set out in sections 521 – 536 of the Income Tax Act 2007 and sections 466 – 493 of the Corporation Tax Act 2010.

⁵⁸⁵ Section 30 of the Act and in England and Wales section 521 of the Income Tax Act 2007 and section 472 of the Corporation Tax Act 2010.

⁵⁸⁶ Section 30 and Part I of the Ninth Schedule to the Act.

⁵⁸⁷ Part II of the Ninth Schedule to the Act.

The 2018 Davis Tax Committee report on Public Benefit Organisations recommends that the list of PBOs be revised to include more categories that are beneficial to the needs of South Africa.⁵⁸⁸ Individuals and corporates can deduct Gift Aid from their annual income tax levy when making a qualifying cash donation to a recognised charity in England and Wales.⁵⁸⁹ The income tax legislation that applies to a South African PBO and a charity in England and Wales limits the scope to perform a business undertaking or trading activity to augment the entity's income. The receipts and accruals received from a business undertaking or trading activity in both countries must meet certain conditions and requirements before such activity will receive preferential tax treatment.

In South Africa, section 10(1)(cN)(ii)(aa) – (dd) describes when the income that a PBO generates from a business undertaking or trading activity enjoys preferential tax treatment under the Income Tax Act of South Africa.⁵⁹⁰ Sections 524(3) and 524(4) of the Income Tax Act in England and Wales set out the conditions that a charitable trust must meet before a trading activity enjoys preferential tax treatment.⁵⁹¹ Section 478 of the Corporation Tax Act outlines the requirements that a charitable company must comply with before the receipts and accruals received from carrying on trading activity in England and Wales enjoys preferential tax treatment.⁵⁹²

If a PBO or charity does not meet the prescribed requirements when performing a business undertaking or trading activity, such receipts and accruals will be charged with ordinary tax. However, the income tax legislation in England and Wales allows for the receipts and accruals received from non-charitable trading activity to enjoy preferential tax treatment if it falls below the prescribed threshold set annually by HMRC.⁵⁹³

⁵⁸⁸ Davis Tax Committee: Public Benefit Organisations Report March 2018 6.

⁵⁸⁹ Section 521 of the Income Tax Act 2007 and section 472 of the Corporation Tax Act 2010.

⁵⁹⁰ Section 10(1)(cN)(ii)(aa) – (dd) of the Act.

⁵⁹¹ Section 524(3)-(4) of the Income Tax Act 2007.

⁵⁹² Section 478 of the Corporation Tax Act 2010.

⁵⁹³ <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-iv-trading-and-business-activities-basic-principles> (Date of use: 30 June 2020).

In South Africa and in England and Wales, it is forbidden to allow for the preferential tax treatment of the receipts and accruals received from a business undertaking or trading activity if such activity is in unfair competition with a commercial entity performing a similar business undertaking or trading activity.⁵⁹⁴

The income tax and corporation tax legislation of England and Wales encourages a charity that carries on trading activities on a large scale to set up a subsidiary company to trade on its behalf. Although the subsidiary company pays the standard tax levies, the payments made to its parent charity reduce its taxable profit.⁵⁹⁵ The South African tax legislation limits the total receipts and accruals that enjoys a tax reduction to a maximum of ten percent of a company or individual per year of assessment.⁵⁹⁶ Any donation made after March 2014 that exceeds the ten percent limitation can be transferred over to the subsequent tax year.⁵⁹⁷

The next chapter will draw to the conclusion the lessons learned in terms of the tax implications of profit share accrual between a PBO in South Africa and a charity operating in England and Wales to augment its annual income.

⁵⁹⁴ <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-iv-trading-and-business-activities-basic-principles> (Date of use: 30 June 2020) and section 10(1)(cN)(aa)(C) of the South African Act.

⁵⁹⁵ <https://www.gov.uk/government/publications/trustees-trading-and-tax-how-charities-may-lawfully-trade-cc35/trustees-trading-and-tax-how-charities-may-lawfully-trade#charities-with-trading-subsidiaries> (Date of use: 30 June 2020).

⁵⁹⁶ Section 18A(1)(A) of the Act.

⁵⁹⁷ Section 18A(1)(B) of the Act.

CHAPTER 5

CONCLUSION

5.1 Introduction

The research is concluded at a time when the outbreak of a global pandemic called coronavirus or more commonly known as COVID-19⁵⁹⁸ (the virus)⁵⁹⁹ highlights the feeble state of South Africa's vulnerable communities and economy.

The 2010 – 2014 statistics report of South Africa stated that the government made a financial contribution of 44.3% to non-profit sector's sum total income in the country.⁶⁰⁰ The total income from business undertakings and trading activities was only 5.7% of the entire income.⁶⁰¹ Income generated from membership subscription makes up only 4.1% of the overall income in the non-profit sector in South Africa.⁶⁰² The income benefited organisations that offer services predominantly in the education, research, and health sectors in South Africa.⁶⁰³

The South African non-profit sector continues to struggle financially. It is unable to meet the country's growing socio-economic challenges. Any income that a Public Benefit Organisation (PBO) generates from a business undertaking or trading activity that falls outside the scope in section 10(1)(cN)(ii), the PBO will be liable to pay a standard tax levy on the said income.⁶⁰⁴

⁵⁹⁸ <https://www.who.int/news-room/q-a-detail/coronavirus-disease-covid-19> (Date of use: 24 October 2020).

⁵⁹⁹ The Centre of Disease Control (CDC) explains coronavirus and covid-19 as:
Coronaviruses are a large family of viruses that can cause illness in animals or humans. In humans, several known coronaviruses that cause respiratory infections. These coronaviruses range from the common cold to more severe diseases such as severe acute respiratory syndrome (SARS), Middle East respiratory syndrome (MERS), and COVID-19.

<https://www.cdc.gov/coronavirus/2019-ncov/hcp/non-us-settings/overview/index.html#background> (Date of use: 6 September 2020).

⁶⁰⁰ Statistics South Africa 2017 http://www.statssa.gov.za/?page_id=1854&PPN=D0407.2&SCH=6988 (Date of use: 12 September 2020).

⁶⁰¹ Statistics South Africa 2017 http://www.statssa.gov.za/?page_id=1854&PPN=D0407.2&SCH=6988 (Date of use: 12 September 2020).

⁶⁰² Statistics South Africa 2017 http://www.statssa.gov.za/?page_id=1854&PPN=D0407.2&SCH=6988 (Date of use: 29 December 2020).

⁶⁰³ Statistics South Africa 2017 http://www.statssa.gov.za/?page_id=1854&PPN=D0407.2&SCH=6988 (Date of use: 12 September 2020).

⁶⁰⁴ Section 10(1)(cN)(ii)(*dd*)(i) of the Act.

The final chapter of this research recapitulates the tax implications of profit share accrual for PBOs in South Africa. The subsequent paragraphs summarise the lessons learned and recommendations in respect of the comparative study between South African PBOs and charities in England and Wales.

5.2 Conclusion on the tax implications of profit share accrual for public benefit organisations

5.2.1 Introduction

The charitable and non-profit sectors' response in South Africa is tremendous but uneven.⁶⁰⁵ The vital role of the South African non-profit sector is often unacknowledged.⁶⁰⁶ The government of South Africa set up the Reconstruction and Development Programme (RDP) in 1994 to create an equal economy and society in South Africa.⁶⁰⁷ The Reconstruction and Development Fund Act 7 of 1994 was promulgated to finance the coordinated implementation of reconstruction and development programmes of the Minister of Finance.⁶⁰⁸

In 1996, the government substituted the RDP with the Growth, Employment and Redistribution (GEAR) strategy. GEAR was the government's scheme to provide tax incentives that would encourage investment by the private sector that would result in socio-economic equality.⁶⁰⁹ The South African government based its response to address the unequal economic and social challenges on the Keynesian theories. Keynesian theories are macro-economic theories that believe that when a government increases its expenditure and decreases its taxes, it stimulates more demand and transforms the economy.⁶¹⁰

⁶⁰⁵ Swilling and Russel 2002 *Centre for Civil Society* University of Natal 8.

⁶⁰⁶ Graham 2008 *National Development Agency of South Africa* 8.

⁶⁰⁷ O'Melly 2004 *African Communist Journal* Extract 134
<https://omalley.nelsonmandela.org/omalley/index.php/site/q/03lv02039/04lv02103/05lv02120/06lv02126.htm> (Date of use: on 16 October 2021).

⁶⁰⁸ Section 3(a) of the Reconstruction and Development Programme Fund Act 7 of 1994.

⁶⁰⁹ Department of Finance 23 <http://www.treasury.gov.za/publications/other/gear/chapters.pdf> (Date of use: 10 March 2021).

⁶¹⁰ Burger and Du Plessis 2013 IGI Global (2013) 30 – 48.

Trevor Manuel, Minister of Finance at the time, declared changes to the South African tax legislation to strengthen the non-profit sector's finances.⁶¹¹ He introduced a new definition of a Public Benefit Organisation to the income tax legislation.⁶¹² Former Minister Manuel also announced that more public benefit activities would qualify for issuing tax-deductible certificates to donors.⁶¹³ In his 2002 Budget Speech, Minister Manuel announced that South African Revenue Service (SARS) broadened the list of qualifying organisations that stimulate social development or address the needs of the public to enjoy preferential tax treatment.⁶¹⁴ Despite the efforts of the government to create enabling environments for non-profit organisations to increase their financial income by enjoying preferential tax treatment, the non-profit sector continued to struggle financially.

5.2.2 Findings

Section 30 of the Income Tax Act 58 of 1962 recognises any one of three main legal entities that can apply to SARS to be approved as a Public Benefit Organisation (PBO) which enjoys preferential tax treatment.⁶¹⁵ A Voluntary Association in South Africa is not registered in terms of any legislation or regulated under any recognised legal authority.⁶¹⁶ It is difficult to estimate the exact number of operating Voluntary Associations because this type of organisation is not obligated to registered under any legal statute.

The Department of Social Development, similarly to SARS, recognises the same legal entities to be eligible for registration as non-profit organisations in South Africa.⁶¹⁷ The three recognised legal entities are an Association of Persons, a Trust and a Nonprofit Company (NPC).⁶¹⁸ An Association of Persons is formed in terms

⁶¹¹ Trevor Manuel Budget Speech 5 <http://www.treasury.gov.za/documents/national%20budget/2000/speech/speech.pdf> (Date of use: 27 February 2021).

⁶¹² Trevor Manuel Budget Speech 20 <http://www.treasury.gov.za/documents/national%20budget/2000/speech/speech.pdf> (Date of use: 27 February 2021).

⁶¹³ Trevor Manuel Budget Speech 20 <http://www.treasury.gov.za/documents/national%20budget/2000/speech/speech.pdf> (Date of use: 27 February 2021).

⁶¹⁴ Trevor Manuel Budget Speech 20 <http://www.treasury.gov.za/documents/national%20budget/2000/speech/speech.pdf> (Date of use: 27 February 2021).

⁶¹⁵ Section 30 of the Act.

⁶¹⁶ The NPO Legal Support Project of the Legal Resources Centre <https://www.etu.org.za/toolbox/docs/building/lrc.html> (Date of use: 21 November 2021.)

⁶¹⁷ Section 1(1)(x) of the Nonprofit Organisations Act 71 of 1997.

⁶¹⁸ Department of Social Development <http://www.npo.gov.za/PublicNpo/WebApplication/Case/Register> (Date of use: 29 May 2021).

of common law in South Africa and not registered under any legislation promulgated in South Africa. It merely requires a written or verbal agreement between three or more people.⁶¹⁹ The main objective of the association of persons formed is that such an objective must be for public benefit and not-for-profit.⁶²⁰ An organisation that operates as an association of persons is the most commonly type of legal entity in the South African non-profit sector.

Section 1 of the Trust Property Control Act 57 of 1988 regulates the registration of a trust. A trust is the second type of legal entity in South Africa that is eligible to apply to register as a nonprofit organisation with the Department of Social Development. A duly registered nonprofit company is the third type of legal entity eligible that may apply for registration as a nonprofit organisation under the Department of Social Development.

The Nonprofit Organisations Act 71 of 1997 (NPO Act) does not force organisations with a non-profit objective to register as a nonprofit organisation. An organisation that operates as an association of persons or a trust or a nonprofit company can operate without registering as a nonprofit organisation or seek approval as a PBO.

All registered NPOs must submit narrative reports on their activities together with a financial statement to the Director of the NPO Directorate of the Department of Social Development every year within nine months after the end of their financial year.⁶²¹ The Director of the NPO Directorate can de-register an NPO if it does not comply with the requirements outlined in section 18 of the NPO Act.⁶²²

No legislation or regulation exists to make it compulsory for any organisation that functions in the non-profit sector to register under the South African income tax legislation. The National Development Plan of South Africa emphasises that the government relies heavily on the non-profit sector to deliver services to poor

⁶¹⁹ Department of Social Development <http://www.npo.gov.za/PublicNpo/WebApplication/Case/Register> (Date of use: 29 May 2021).

⁶²⁰ Section 1(1)(x) of the Nonprofit Organisations Act 71 of 1997.

⁶²¹ Section 18(1)(a) of the Nonprofit Organisations Act 71 of 1997.

⁶²² Section 21 of the Nonprofit Organisations Act 71 of 1997.

communities.⁶²³ Major international funding organisations started to withdraw from financially supporting the South African non-profit sector at the start of 2000.

As stated in chapter 4, section 30 of the Act⁶²⁴ sets out the requirements that organisations and companies must meet before the Commissioner for SARS will approve it as a Public Benefit Organisation in South Africa. Only an approved PBO may apply to the Commissioner for SARS for preferential tax treatment.⁶²⁵ If an organisation is not an approved PBO under section 30 of the Act, it will not qualify for preferential tax treatment. Organisations operating as nonprofit organisations or companies do not enjoy automatic preferential tax treatment in South Africa, but only after approval under section 30 of the Act.

In 1999, the Katz Commission raised the concern that the unique nature of NPOs and their activities make it difficult for the South African tax legislation to define business concepts such as

“income”, “expenditure”, “trading” and “in separating accruals of a capital nature (such as donations) from accruals from a revenue nature”.⁶²⁶

The enjoyment of complete tax exemption of approved PBOs in South Africa is restricted under the income tax legislation, especially in respect of the receipts and accruals received from a business undertaking⁶²⁷ and trading activity that falls outside the scope provided for in section 10(1)(cN)(ii)(aa) – (dd) of the Income Tax Act 58 of 1962.⁶²⁸ An approved PBO that carries on a business undertaking or trading activity must comply with the conditions outlined in section 10(1)(cN)(ii)(aa) – (dd) of the Act before the receipts or accruals received from such undertaking or activity will enjoy preferential tax treatment in South Africa.

Any trading activity or business undertaking of an approved PBO that does not meet any one of the conditions that are listed in of section 10(1)(cN)(ii) of the Income Tax

⁶²³ The National Development Plan 230 334 [Chap-09_N \(nationalplanningcommission.org.za\)](http://nationalplanningcommission.org.za) (Date of use: 6 December 2020).

⁶²⁴ Section 30 of the Act.

⁶²⁵ Section 10(1)(cN) of the Act.

⁶²⁶ Katz *et al* (1999) Ninth Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa 3.

⁶²⁷ Section 10(1)(cN)(ii) of the Act.

⁶²⁸ Section 10(1)(cN)(ii) of the Act.

Act 58 of 1962 is charged with the standard tax rate in South Africa.⁶²⁹ If a business undertaking or trading activity that a PBO carries on does not fall within the categories of section 10(1)(cN)(ii)(aa) - (cc) of the Act, the total receipts and accruals must be more than five (5) percent or two hundred thousand Rands (R200 000), whichever is more, in any tax year of assessment.⁶³⁰

When an individual, a company or a trust donates money to an approved PBO, such donation enjoys preferential tax treatment.⁶³¹ However, the total receipts and accruals of the donation must not be more than ten percent of the total taxable income of the donor.⁶³² If a donor donates more than the allowable ten percent limitation to an approved PBO that is also approved to issue a tax-deductible tax certificate under section 18A of the Act, the excess amount is transferable to the following tax years of assessment but is always limited to the ten percent threshold.⁶³³

England and Wales have some of the oldest charities in the world. The English tradition expanded these charitable or philanthropic services to poor communities of non-white ethnic backgrounds in South Africa. The research finds that the essential elements that define a (PBO) in South Africa⁶³⁴ are very similar to the essential elements that define charities in England and Wales⁶³⁵.

In comparison to South African courts, the courts in England and Wales dealt with many more cases that tested the courts' interpretation of "charities". The criteria for the approval of a South African PBO is very similar to that of charities in England and Wales. An approved PBO in South Africa and a recognised charity in England and Wales must fall into the categories of any one of the prescribed legal entities, established for a charitable/non-profit purpose; the main objective must be to benefit

⁶²⁹ The standard tax rate for companies and trusts are at 28% and 45% respectively and capital gains tax are charged at a rate of 22.4% and 36% respectively <https://www.sars.gov.za/Tax-Rates/Income-Tax/Pages/Companies-Trusts-and-Small-Business-Corporations.aspx> and (Date of use:5 September 2020).

⁶³⁰ Section 10(1)(cN)(ii)(dd) of the Act.

⁶³¹ Section 18A of the Act.

⁶³² Section 10(1)(cN)(ii)(dd)(i) of the Act.

⁶³³ Section 18(A)(1)(B) of the Act.

⁶³⁴ Section 30 of the Act.

⁶³⁵ Section 1 of Part 1 of the Charities Act 2011.

the general public; and upon dissolution, it must donate its assets to a similar organisation.

It is difficult to report on the total number of organisations that work in the non-profit sector in South Africa. Unlike England and Wales, South Africa does not have a centralised authority to regulate, record, maintain and publish current information on organisations which provide services in the non-profit sector. Service organisations in the non-profit sector can elect to register as a NonProfit Organisation⁶³⁶, Trust⁶³⁷, NonProfit Company (NPC)⁶³⁸ or a Voluntary Association (VA). The largest group of organisations that provides socio-economic services in the non-profit sector is known as voluntary associations or an association of persons that require no registration under any legislation or authority in South Africa.

In terms of the 2010-2014 census conducted in South Africa, voluntary associations made up approximately 95% (114 103) of the total (120 227) non-profit sector, followed by the 3% (3 856) organisations registered as NPCs and 2% (2 259) registered as trusts.⁶³⁹ The Department of Social Development registered 232 964 NPOs and 4 138 organisations awaiting approval of their application for registration.⁶⁴⁰ England and Wales have a centralised authority called the Charity Commission, which regulates, records, maintains and publishes all relevant information on registered charities operating in England and Wales on its website.⁶⁴¹ The Charities Act outlines the powers and functions of the Charity Commission.⁶⁴² All organisations, whether registered as a charity or a company, must register with the Charity Commission if it receives a yearly income of £5 000 or more.⁶⁴³ South Africa has umpteen organisations operating in the non-profit sector, but it has a minimal number of approved PBOs and an even smaller number of approved

⁶³⁶ Section 1 of the Nonprofit Organisations Act 71 of 1997.

⁶³⁷ Section 1 of the Trust Property Control Act 57 of 1988.

⁶³⁸ Section 1 of the Companies Act 71 of 1998.

⁶³⁹ Statistics South Africa http://www.statssa.gov.za/?page_id=1854&PPN=D0407.2&SCH=6988 (Date of use: 12 September 2020).

⁶⁴⁰ Department of Social Development <http://www.npo.gov.za/> (Date of use: 12 September 2020).

⁶⁴¹ Charity Commission for England and Wales (<https://register-of-charities.charitycommission.gov.uk/sector-data/sector-overview>) (Date of use: 12 September 2020).

⁶⁴² Sections 14, 15 and 16 of Part 2 of the Charities Act 2011.

⁶⁴³ Section 13(1) of Part 2 of the Charities Act 2011.

PBOs that may issue section 18A tax-deductible certificates. The application to be approved as a PBO⁶⁴⁴ and to issue a section 18A tax-deductible certificate⁶⁴⁵ to a donor or funder is voluntary and not compulsory for benevolent and philanthropic organisations in South Africa.

As stated in chapter 2 the Tax Exemption Unit (TEU) that is located in SARS examines and approves organisations as a PBO and also approves their qualification to issue a tax-deductible certificate to a donor or funder.⁶⁴⁶ The TEU records, updates and publishes information on the names of the PBOs that are approved to issue section 18A tax-deductible certificates.

The SARS website on which the information on PBOs is published contains the names of every PBO that may issue a section 18A tax-deductible certificate⁶⁴⁷ but not the total number of approved PBOs or a total number PBOs that are approved to issue section 18A tax-deductible certificates in South Africa. The SARS and Department of Social Development's websites make it difficult to get summarised information instantly. England and Wales have detailed and updated information on all registered charities that is easily accessible on the website of HMRC. This website gives an overview of the total number of registered charities and the charitable sector's income.⁶⁴⁸ The charities in England and Wales generate most of their income from conducting charitable activities and not from donations, which provides the third-highest income to the charitable sector.⁶⁴⁹

Before 2000, all organisations that implemented activities with a benevolent or philanthropic intent in South Africa did not pay a tax levy on their income received.⁶⁵⁰

⁶⁴⁴ Section 30 of the Act.

⁶⁴⁵ Section 18A of the Act.

⁶⁴⁶ SARS <https://www.sars.gov.za/ClientSegments/Businesses/TEO/Pages/default.aspx> (Date of use: 12 September 2020).

⁶⁴⁷ Section 18A of the Act.

⁶⁴⁸ Charity Commission Charities in England and Wales – 12 September 2020 <https://register-of-charities.charitycommission.gov.uk/sector-data/sector-overview> (Date of use: 12 September 2020). The Charity Commission for Northern Ireland <https://www.charitycommissionni.org.uk/> (Date of use: 12 September 2020). The Scottish Charity Regulator <https://www.oscr.org.uk/> (Date of use: 12 September 2020).

⁶⁴⁹ Charity Commission Charities by income category <https://register-of-charities.charitycommission.gov.uk/sector-data/sector-overview> (Date of use: 12 September 2020).

⁶⁵⁰ SARS Tax Exemption Guide for Public Benefit Organisations in South Africa Issue 5 26 January 2017 3 <https://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-IT-G26%20->

The Katz Commission highlighted concerns that the then complete tax exemption for benevolent and philanthropic organisations may result in unfair competition and be abused by taxpayers.⁶⁵¹ SARS introduced sections 30 and 10(1)(cN) into the income tax legislation after the recommendations made by the Katz Commission^{652, 653}

Sections 30 and 10(1)(cN) group benevolent and philanthropic organisations into PBOs and restrict the preferential tax treatment when a PBO performs any trading activity or business undertaking to augment its income that falls outside the scope provided for in section 10(1)(cN)(ii) of the Income Tax Act 58 of 1962.⁶⁵⁴ The Davis Tax Committee has raised concerns of multi-legal compliance that organisations in the benevolent and philanthropic sector have to comply with, the narrow list of categories that allows PBOs to issue section 18A tax-deductible certificates⁶⁵⁵ and the limited capacity that the TEU has which results in the delay of the approval of PBOs in South Africa.⁶⁵⁶

Although section 18A provides tax relief to individual and corporate donors and funders who make donations to an approved PBO, such a donation is restricted to not more than 10% of the taxable income in a year of assessment.⁶⁵⁷ If a donation exceeds that threshold, the remaining amount of the donation can be considered in the succeeding year of tax assessment.⁶⁵⁸

A taxpayer in South Africa who donates to an approved PBO cannot exceed 10% of the dutiable income of the said taxpayer in any year of tax assessment.⁶⁵⁹ If the

[%20Tax%20Exemption%20Guide%20for%20Public%20Benefit%20Organisations%20in%20South%20Africa.pdf](#) (Date of use: 12 September 2020).

⁶⁵¹ Katz *et al* (1999) Ninth Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa 3.

⁶⁵² Katz *et al* (1999) Ninth Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa.

⁶⁵³ Section 21(1)(c) and section 35(1) of the Taxation Laws Amendment Act 30 of 2000 introduced section 10(1)(cN) and section 30, respectively. The amendments came into operation on 15 July 2001.

⁶⁵⁴ Sections 30 and 10(1)(cN) of the Act.

⁶⁵⁵ Part II of the Ninth Schedule to the Act.

⁶⁵⁶ Davis Tax Committee: Public Benefit Organisations Report March 2018 17-26.

⁶⁵⁷ Section 18A of the Act.

⁶⁵⁸ Section 18B of the Act.

⁶⁵⁹ Section 18A of the Act.

said donation exceeds the 10% threshold, the amount in excess can roll over to the following year of tax assessment.⁶⁶⁰ Individuals and corporates in England and Wales can deduct Gift Aid from their annual income tax levy for any qualifying cash donation made to a recognised charity.

There is no restriction on the amount that an individual can deduct from the taxable income for a year of assessment in England and Wales. However, a corporation is limited to reduce its tax levy to nil for a year of assessment. The recognised charity that receives the qualifying cash donation from the individual or corporate can also claim Gift Aid from the same cash donation made in the year of assessment in England and Wales. A donor can also claim Gift Aid for small cash donations or contactless card donations under the Gift Aid Small Donations Scheme (GASDS), which tax-deductible amount may not be more than ten times the amount of Gift Aid claimed, as explained in chapters three and four.⁶⁶¹

There are specific requirements and conditions that an approved PBO in South Africa or a recognised Charity in England and Wales must adhere to before the receipts and accruals that derive from business undertakings or trading activities could receive preferential tax treatment. The requirements and conditions are discussed in detail in chapters two, three and four of the study. The income tax legislation in South Africa does not encourage a close relationship between an organisation with a non-profit purpose, and a corporation whose main objective is to make a profit.

The South African income tax legislation does not recognise social enterprises, whereas the income tax legislation in England and Wales recognises and provides for preferential tax treatment of social enterprises. Section 257J(2) of the Income Tax Act 2007 explains that a social enterprise for the purposes of income tax legislation means a “community interest company”⁶⁶², “community benefit society

⁶⁶⁰ Section 18A of the Act.

⁶⁶¹ HMRC Guide <https://www.gov.uk/claim-gift-aid> (Date of use: 13 September 2020).

⁶⁶² Section 257J(2)(a) of the Income Tax Act 2007.

that is not a charity”⁶⁶³, “charity”⁶⁶⁴, “an accredited social impact contractor”⁶⁶⁵ or “any other body prescribed, or of a description prescribed, by an order made by the Treasury”⁶⁶⁶.⁶⁶⁷ The Government of the United Kingdom defines the term “social enterprise” as “a business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders and owners”.⁶⁶⁸ According to the said definition, the government interprets the term “social enterprise” to “describe the purpose of a business and not its legal form”.⁶⁶⁹ Despite the fact that an NPC is one of the legal entities that can seek approval as a PBO and approval to issue section 18A tax-deductible certificates to its donors, the NPC is restricted in terms of section 10(1)(cN)(ii)(aa) - (dd) if it receives income from any business undertaking or trading activity.⁶⁷⁰ The South African income tax legislation prevents an approved PBO from using its donations received to set up a for-profit company to help augment its finances.⁶⁷¹ Charities in England and Wales, however, are encouraged to set up subsidiary trading companies if it intended any trading activity that is not linked to its primary purpose.⁶⁷²

HMRC allows the subsidiary company to deduct the donations paid to its parent charity up to a maximum of zero profit.⁶⁷³ Any amount more than the prescribed limit on donations made from a subsidiary company to its parent charity will be liable for corporations’ tax in England and Wales. The income tax legislation in England and

⁶⁶³ Sections 257J(2)(b) and 257JB of the Income Tax Act 2007.

⁶⁶⁴ Section 257J(2)(c) of the Income Tax Act 2007.

⁶⁶⁵ Sections 257J(2)(d) and 257JD of the Income Tax Act 2007.

⁶⁶⁶ Section 257J(2)(e) of the Income Tax Act 2007.

⁶⁶⁷ Section 257J of the Income Tax Act 2007.

⁶⁶⁸ Department for Business Innovation and Skills A guide to legal forms for social enterprises https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31677/11-1400-guide-legal-forms-for-social-enterprise.pdf (Date of use: 21 November 2022).

⁶⁶⁹ Department for Business Innovation and Skills A guide to legal forms for social enterprises https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31677/11-1400-guide-legal-forms-for-social-enterprise.pdf (Date of use: 21 November 2022).

⁶⁷⁰ Section 10(1)(cN)(ii)(aa)-(dd) of the Act.

⁶⁷¹ Section 30(3)(b)(ii) of the Act.

⁶⁷² Section 398 of the Corporation Tax Act 2010.

⁶⁷³ HMRC and the Charities Commission Guidance <https://www.gov.uk/guidance/charities-and-trading#subsidiary-trading> (Date of use: 13 September 2020).

Wales furthermore includes the tax implications of social investments made in social enterprises.⁶⁷⁴

5.2.3 Recommendations

The South African Parliament amended the income tax legislation in early 2000. This amendment defined a PBO and introduced the concept of preferential tax treatment for such organisations. However, it has had the opposite effect in South Africa. When most of the support received from international donors and funding agencies to non-profit sector in South Africa started rapidly declined after the dawn of democracy in 1994 several well-known Non-Governmental Organisations (NGOs) terminated their operations due to lack of sufficient financial resources.

The total income that the non-profit sector receives determines the number of beneficiaries it can serve, the duration of its services and the geographic areas in which it can function. The more NPOs continue to struggle financially, the less likely it will be that much needed services will reach the poor and disadvantaged people in South Africa. The recommendations below aim to symmetrise the South African government's amendments to the income tax legislation to strengthen the non-profit sector financially.

The first recommendation is that the South African government analyses and incorporates social enterprises that could be hybrid entities or groups that reinvest its surplus funds from business activities to carry on their public benefit activities without any limitation on their annual income, Gift Aid, and the Gift Aid Small Donations Scheme in the income tax legislation in England and Wales into the South African income tax legislation. PBOs can use these aid concepts, if introduced into the South African income tax legislation, to increase its income for the purposes of carrying on the public benefit object of the PBO.

The second recommendation is that the Commissioner for SARS includes more categories in Part II of the Ninth Schedule to the Act. Part II excludes six of the eleven categories included in Part I of the Ninth Schedule to the Act. The growing

⁶⁷⁴ Section 257J of the Income Tax Act 2007.

number of South African unemployed youth poses a considerable risk for South Africa's economic growth. One of the categories omitted from Part II is cultural activities which is a category that includes youth development. The Davis Tax Committee recommended in its March 2018 report on PBOs that SARS must revise the exclusions from Part II so that the categories concentrate on the specific needs that exist in South Africa. Expanding the scope of the existing categories will enable more PBOs to obtain approval to issue tax-deductible certificates to their donors.

5.3 Conclusion

The most important sections that affect the income tax liability of a not-for-profit organisation in South Africa are sections 30, 10(1)(cN), 18A, 26A and paragraph 63A of the Eighth Schedule to the Income Tax Act 58 of 1962 (the Act). Section 30 contains the requirements for the approval of a Public Benefit Organisation (PBO), which is a requirement to qualify for any preferential tax treatment in terms of section 10(1)(cN) of the Act.⁶⁷⁵ Section 10(1)(cN)(ii) describe when the receipts and accruals that derive from any business undertakings or trading activities carried on by the PBO may be exempt paying income tax in any year of tax assessment.⁶⁷⁶ The income tax legislation in South Africa does not want to encourage unfair competition between PBOs and for-profit companies.⁶⁷⁷ There is not many caselaw on testing the court's interpretation of any one of the conditions mentioned in sections 30 and 10(1)(cN)(ii) of the Act, but SARS has used different instruments like Interpretation notes and Guides to help the public understand the content of the said sections.⁶⁷⁸ Part I and Part II of the Ninth Schedule to the Act helps an organisation to fulfil one of the requirements for approval as a PBO and to issue the donors with a section 18A tax-deductible certificate respectively.⁶⁷⁹ It is not clear why it is still necessary to exclude some of the categories in Part II that forms part of Part I of the Ninth Schedule to the Act.

In analysing the scope of preferential tax treatment and the benefits that are available to PBOs in South Africa with charities in England and Wales, there is room

⁶⁷⁵ Section 30 read together with section 10(1)(cN) of the Act.

⁶⁷⁶ Section 10(1)(cN)(ii) of the Act.

⁶⁷⁷ Section 10(1)(cN)(ii)(aa)(C) of the Act.

⁶⁷⁸ SARS <https://www.sars.gov.za/legal-counsel/> (Date of use: 21 November 2022).

⁶⁷⁹ Sections 30 and 18A of the Act.

for South Africa to increase the existing scope of the preferential tax treatment of PBOs to include social enterprises, a concept of Gift Aid and Gift Aid Small Donations Scheme.

The brunt of COVID-19 on the socio-economic challenges of poor communities in South Africa exposes the crucial role that the non-profit sector plays in addressing these in areas and communities where government and businesses cannot reach. The research reveals that it is essential to evaluate the scope of the existing income tax legislation in South Africa that limits approved PBOs from augmenting their income through business undertakings and trading activities. The income tax legislation in South Africa limits the maximum amount that a taxpayer can donate to a PBO per year, but it makes it possible through section 18A to roll over the excess donation to the following year of tax assessment. It means PBOs remain heavily reliant on donations from individual donors or funders, restricting their ability to grow and reach more poor communities in South Africa. More in-depth research including a wider variety of countries would assist in informing the South African government on what changes would help strengthen, rather than restrict, the services that PBOs offer to poor and struggling communities and people in South Africa.

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