



INSIGHTS

3RD SECTOR LAW

2 March 2009

Insights into: The Revenue Laws Amendment Bill, 2008

The Revenue Laws Amendment Act, No. 60 of 2008, (the Act) was promulgated early 2009. The Act contains a number of beneficial changes relevant to the non-profit sector. This document serves as a summary of the key changes as it relate to public benefit organisations (PBOs).

1. Increase of limit on trading activities for public benefit organisations:

Section 10 (1) (cN) of the Income Tax Act makes provision for an approved PBO to be partially exempted from the payment of income tax. A PBO will be taxed on its business or trading income that exceeds the limitations listed in that sub-section. There are four categories of trading activities that are not taxed. In short, the first category refers to trading that is related to the objectives of the PBO, the second category refers to trading that is of an occasional nature and the third category refers to trading that may be approved by the Minister of Finance. The last category is commonly referred to as the *basic exemption category*. If any trading activities do not fall within the first three categories, but it still falls within the ambit of the basic exemption category, it will not be taxed.

The basic exemption category is the only category that actually specifies a monetary limit on the trading income. This limit, currently being, the maximum of five per cent (5%) of the total receipts and accruals of the PBO or R100 000-00. This category is sometimes, mistakenly, seen as the absolute limit on trading income before the PBO has to be taxed. This is not correct as a PBO may still carry on trading activities in excess of these limits,

without being taxed, provided such trading activities fall within the other three trading categories. See **Table 1** at the end.

Amendment: The amount of R100 000-00, under the basic exemption category, is now increased to R150 000-00. This would mean that any trading below R150 000-00 will automatically be exempt from tax. This amendment comes into operation on 01 March 2009 and applies to years of assessment starting on or after that date.

2. Exemption and 18A for foreign entities

The Income Tax Act makes provision for foreign non-profit entities operating in South Africa also to be (partially) exempted from the payment of income tax. These entities are not established in terms of the laws of South Africa. To benefit from this partial tax exemption, such entities must be exempted from tax in their countries of origin. It is also required that such entities must, when terminating their activities in South Africa, transfer the locally-based assets to a local PBO or exempt institution (if more than fifteen percent of its local assets and income were received from a South African source in the preceding three years). Donations to such foreign non-profit entities, were in the past, not deductible under section 18A.

Amendment: Section 18A of the Income Tax Act has been amended to allow for donations to certain agencies, defined as specialised agencies in terms section 1 of the *Convention on the Privileges and Immunities of the Specialized Agencies, 1947*, set out in Schedule 4 to the *Diplomatic Immunities and Privileges Act, 2001* (Act No. 37 of 2001), to be deductible under that section. These include institutions like The International Labour Organization; The Food and Agriculture Organization of the United Nations; The International Monetary Fund and The World Health Organization. Agencies seeking to make use of this benefit must:

- comply with the requirements set out in section 18A; and
- sign a written undertaking and waive diplomatic immunity that will allow the Commissioner for the South African Revenue Service to deem a donation, in certain cases, as taxable.

This section is deemed to have into operation as from the commencement of years of assessment ending on or after 1 January 2009.

3. Exclusion of retirement lump sum withdrawal benefits

Any donation made in terms of section 18A can only qualify for a deduction up to a maximum of ten per cent (10%) of the taxable income of the donor. The ten percent excludes any retirement fund lump sum benefit. The Pension Funds Act makes provision for a non-member spouse to receive a share of the member's pension interest in the form of a lump sum within sixty days of their divorce.

Amendment: Section 18A has been amended to allow for the retirement lump sum withdrawal benefit, contemplated under the Pension Funds Act, to also be excluded from the maximum of ten percent. This means that any retirement lump sum withdrawal benefit will not be taken into account when calculating the taxable income for purposes of this section. This amendment comes into operation on 01 March 2009 and applies in respect of lump sum benefits withdrawn on or after that date.

4. New section 64F (c) of the Income Tax Act

Section 64C (2) (a) of the Income Tax Act provides that any cash or asset distributed or transferred by a company to (or for the benefit) of a shareholder or any connected person in relation to that shareholder shall, subject to the provisions of Section 64C (4), be deemed to be a dividend declared by a company to a shareholder.

This means that PBOs that have shares in another company must pay dividends tax on any dividends that are declared or assets that are distributed. Although there are a number of exceptions to this rule, none specifically exempt PBOs from the payment of dividends tax. Some PBOs have found this provision problematic because the proceeds of such shares are being used for the public benefit and, argued that, such proceeds should also be exempted from dividends tax.

Amendment: A new section 64F now provides that, in terms of clause (c) thereof, dividends paid by a company to approved PBOs are exempted from dividends tax. This means that approved PBOs will not be required to pay dividends tax, even though it may be a shareholder of that company. This section is not yet in operation and will come into operation on a date determined by the Minister of Finance.

5. Other amendments

- a.* The Act makes provision for a new Schedule Six that deals with micro businesses with an annual qualifying turnover of less than R1 million. There are number of specific provisions that would apply to these micro businesses to ease their administrative burden. Approved PBOs are specifically excluded from the definition of a micro business. Dividends of less than R200 000-00 per year paid by a micro business to a PBO will be excluded from dividends tax. This will further support sustainability efforts by smaller PBOs. Schedule Six comes into operation on 1 March 2009.
- b.* The provision of funds by approved PBOs to foreign non-profit entities that are tax exempt in their countries of origin will now be regarded as public benefit activities. This means that approved PBOs will now no longer be restricted from doing work in other countries or from supporting the public benefit activities of foreign entities.

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Table 1:

Summary of trading limitations contained in section 10 (1) (cN) of Income Tax Act:

CATEGORIES	CONDITIONS
First category	Trading activity is: <ul style="list-style-type: none">▪ Integral and directly related to sole or principal object of the PBO;▪ Carried out or conducted on a basis substantially the whole which is directed towards the recovery of cost; and▪ Not resulting in unfair completion in relation to taxable entities.
Second category	Trading activity is: <ul style="list-style-type: none">▪ Of an occasional nature; and▪ Undertaken substantially with assistance on a voluntary basis without compensation.
Third category	Trading activity is: <ul style="list-style-type: none">▪ Approved by the Minister of Finance by notice in the Government Gazette, having regard to:<ul style="list-style-type: none">○ the scope and benevolent nature of the undertaking or activity;○ the direct connection and interrelationship of the undertaking or activity with the sole or principal object of the PBO;○ the profitability of the undertaking or activity; and○ the level of economic distortion that may be caused by the tax exempt status of the PBO carrying out the undertaking or activity
Fourth category	Excluding the above, the trading activity does not exceed the greater of: <ul style="list-style-type: none">▪ five per cent of the total receipts and accruals of that PBO during relevant year of assessment; or▪ R100 000 (<i>as from 01 March 2009 – this will be R150 000</i>)