PUBLIC BENEFIT ORGANISATIONS – WELFARE AND HUMANITARIAN ACTIVITIES WITH SPECIFIC REFERENCE TO COMMUNITY DEVELOPMENT FOR POOR AND NEEDY PERSONS AND ANTI-POVERTY INITIATIVES

The Income Tax Act No 58 of 1962 (the Act) currently contains two provisions which would apply to any operation which has as its aim to provide financial assistance to promote entrepreneurship. These are section 10(1)(cA) of the Act and section 30 (read with Part 1 of the Ninth Schedule) of the Act which applies to Public Benefit Organisations (PBOs).

1. Section 10(1)(cA)

1.1. Section 10(1)(cA) of the Act provides for the exemption from tax “the receipts and accruals of –

(i) any institution, board or body (other than a company registered or deemed to be registered under the Companies Act, 1973 (…) … and any co-operative, and any close corporation and any trust …), established by or under any law and which, in the furtherance of its sole or principle object –

(cc) carries on activities (including the rendering of financial assistance by way of loans or otherwise) designed to promote commerce, industry or agriculture or any branch thereof” (our emphasis).

1.2. This section has limited application as it only applies to public entities, that is, entities specifically established by national or provincial legislation [ITC 1788 (67 SATC 161)]. It is therefore not applicable to situations where taxpayers or other interest groups established PBOs with the view to promote commerce, industry or agriculture by means of providing financial assistance to new businesses.
2. Section 30 and Ninth Schedule

2.1. Section 30 of the Act regulates the taxation of PBOs. Part 1 of the Ninth Schedule to the Act provides details of the activities which are considered qualifying public benefit activities.

2.2. Paragraph 1(p) of Part 1 of the Ninth Schedule of the Act includes certain initiatives such as community development for the poor and needy and anti-poverty initiatives as qualifying activities. These activities include:

2.2.1. The promotion of community-based projects relating to self-help, empowerment, capacity building, skills development or anti-poverty (Paragraph 1(p)(i)),

2.2.2. The provision of training, support or assistance to community-based projects relating to self-help, empowerment, capacity building, skill development or anti-poverty (Paragraph 1(p)(ii)); or

2.2.3. The provision of training, support or assistance to emerging micro-enterprises to improve capacity to start and manage businesses, which may include the granting of loans on such conditions which may be prescribed by the Minister by way of regulation (Paragraph 1(p)(iii)).

2.3. The Minister of Finance has yet to issue the regulation as specified. As no regulation has been issued, we understand that the tax exemption unit of SARS is currently not considering any cases where the specified activities of the PBOs relate to the provision of training, support or assistance to emerging micro-enterprises to improve capacity to start and manage businesses, which may include the granting of loans.

2.4. The failure to issue the regulations impacts significantly on a number of potential initiatives which will provide support or assistance to upcoming entrepreneurs in need of finance to start their own businesses. This is due to the following:

2.4.1. It is unclear what type of enterprise would qualify as “emerging micro-enterprises” as this has not been defined in the Act; and

2.4.2. PBO’s are unable to grant any loans as the terms and conditions which may be applicable to any loans granted cannot be met.

2.5. A further issue that needs clarification is the meaning of the term “poor and needy”.
3. **Background**

3.1. It is widely believed that small and medium-sized enterprises (SMEs) are the primary drivers of job creation throughout the world.

3.2. The current profile of South African businesses is representative of the developed world as it comprises a small number of large enterprises with few SMEs. This profile is inappropriate considering that South Africa is in reality a developing country. In addition, South Africa is lagging far behind the majority of the developing world in so far as the number of and growth in SMEs.

3.3. Partly as a consequence, the large-scale unemployment in South Africa is a significant impediment to economic advancement and the achievement of a quality standard of living amongst the majority of South Africans. Economic empowerment through the promotion of entrepreneurship is the most likely approach to alleviate this problem.

3.4. There are a number of tertiary education support programmes which are supported by enterprises and entrepreneurs. These taxpayers hold the view that entrepreneurship and enterprise begins with education, particularly in areas such as commerce (business science) and sciences (including engineering). Successful students in these disciplines are not only contributors to corporate South Africa but are also more likely future entrepreneurs.

3.5. As part of achieving the overall objective to encourage entrepreneurship, and specifically black entrepreneurship, a number of large enterprises and entrepreneurs are desirous to establish focused PBOs which will provide finance to such potential entrepreneurs – identified through various means such as from successful students at tertiary educational institutions to participants in management training programmes - to enable them to start their own businesses.

3.6. The terms applicable to the finance granted is intended to be less onerous than those that would apply generally in the market, and the PBOs intend to reinvest any capital and returns generated in future enterprises.

3.7. Further, the intended finance may not be limited to loans but could include other financing options such as shares, debentures etc. for various reasons such as, amongst others, the capital requirements of the intended business operations of the SMEs and expected break-even periods of such capital intensive operations.

3.8. In addition to the provision of finance, the PBOs usually intend to provide managerial support as and when required until such time as the entrepreneurs have established themselves.

3.9. The PBOs hope to overcome two of the significant impediments facing aspiring entrepreneurs, i.e. skills development and access to capital.
4. **Recommendations**

4.1. A number of amendments have been incorporated in our tax legislation to promote Black Economic Empowerment (BEE) and there are further amendments that are currently being considered to avoid additional tax costs that could undermine the necessary financing of BEE restructurings.

4.2. A significant number of the BEE restructurings have however been limited to the change in the ownership profiles of the large enterprises. The current legislation has therefore benefited only a small number of taxpayers.

4.3. The current profile of South African businesses is representative of the developed world, as it comprises a small number of large enterprises with few SMEs. This profile is inappropriate considering that South Africa is in reality a developing country and SME’s are the primary drivers of job creation.

4.4. Economic empowerment through the promotion of entrepreneurship is the most likely approach to alleviate the high unemployment rate as well as contribute in a positive way towards the greater BEE objectives.

4.5. We accordingly recommend that consideration be given to:

4.5.1. The extension of paragraph 1(g)(iii) of Part 1 of the Ninth Schedule to the Act to include the provisions of financial assistance to SMEs;

4.5.2. The extension of the same paragraph to include financial assistance by other means such as shares, debentures etc. similar to that provided for in terms of section 10(1)(cA)(i)(cc) of the Act;

4.5.3. To introduce regulations regarding the conditions of granting loans to encourage the support and advancement of SMEs and defining micro-enterprises.

4.6. In the alternative, that consideration be given to in inclusion in section 10 of the Act of a provision similar to section 10(1)(cA) which will apply to institutions, boards or bodies **not established by or under any law** approved by the Commissioner based on similar criteria as set out in section 30(3) of the Act.

Please do not hesitate to contact me should you require further information.

Yours faithfully

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