

DRAFT INTERPRETATION NOTE

DATE:

ACT : INCOME TAX ACT 58 OF 1962
SECTION : SECTION 10(1)(yA)
SUBJECT : EXEMPTION FOR INTERNATIONAL AID RECEIVED OR ACCRUED UNDER AN OFFICIAL DEVELOPMENT ASSISTANCE AGREEMENT

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Preamble

In this Note unless the context indicates otherwise –

- “**Constitution**” means the Constitution of the Republic of South Africa, 1996;
- “**DAC**” means the OECD Development Assistance Committee;
- “**Minister**” means the Minister of Finance;
- “**normal tax**” means income tax, and these terms are used interchangeably;
- “**ODA**” means official development assistance;
- “**OECD**” means the Organisation for Economic Co-operation and Development;
- “**section**” means a section of the Act;
- “**the Act**” means the Income Tax Act 58 of 1962;
- any other word or expression bears the meaning ascribed to it in the Act.

1. Purpose

This Note provides guidance on the application of section 10(1)(yA) and the requirements that have to be met before an exemption can apply.

2. Background

South Africa has for many years been receiving aid from developed countries usually in the form of ODA grants, discounted loans or discounted technical services. As a precondition to providing the aid under an ODA agreement, foreign donors often seek to have the ODA grants remain free from all taxes and duties in the recipient country to ensure that the full amount of the grant be spent as intended.

An ODA agreement is entered into between a foreign government and the government of South Africa. It therefore bears the stamp of the executive authority by virtue of section 231(3) of the Constitution.¹ These agreements, however, do not override Parliamentary enacted legislation as only an act of Parliament can alter another act of Parliament. SARS can therefore not give effect to any exemption contained in an ODA agreement that is inconsistent with domestic tax law.

Before section 10(1)(yA) was introduced, the tax relief provisions within ODA agreements and their relationship to domestic tax law were not dealt with under a specific provision of general application and was considered on an *ad hoc* basis. In an attempt to provide certainty and clarity, section 10(1)(yA) was introduced.² This section allows for a general exemption to be claimed on amounts received by or accrued to a person in consequence of an ODA agreement, provided that all the requirements of

¹ This section reads as follows: “An international agreement of a technical, administrative or executive nature, or an agreement which does not require either ratification or accession, entered into by the national executive, binds the Republic without approval by the National Assembly and the National Council of Provinces, but must be tabled in the Assembly and the Council within a reasonable time.”

² Inserted by section 10(1)(u) of the Revenue Laws Amendment Act 20 of 2006 followed by various amendments to the section effected by the Taxation Laws Amendment Acts 17 of 2017 and 23 of 2018.

the section are satisfied. A taxpayer does not have to apply to SARS for the exemption. The exemption is automatic if all the requirements are met.

Since the terms of each ODA agreement are different and there is no uniform proforma agreement, this Note will not consider the ODA process and agreements in detail, but will highlight some general principles. The effects of a tax treaty, issues relating to value-added tax and the exemption of payroll taxes are also beyond the scope of this Note and will also not be considered.

3. The law

Section 10(1)(yA)

10. Exemptions.—(1) There shall be exempt from normal tax—

(yA) any amount received by or accrued to any person in respect of goods or services provided to beneficiaries in terms of an official development assistance agreement that is binding in terms of section 231 (3) of the Constitution of the Republic of South Africa, 1996, to the extent—

(aa) that amount is received or accrued in relation to projects that are approved by the Minister; and;

(bb) where that agreement was concluded on or after 1 January 2007, that agreement provides that those receipts and accruals of that person must be exempt; ...

4. Application of the law

4.1 General background to the official development assistance process

4.1.1 Objectives and criteria that constitute an official development assistance agreement

The OECD's Development Assistance Committee defines ODA as –

“government aid that promotes and specifically targets the economic development and welfare of developing countries.”³

An ODA agreement is entered into with specific goals and objectives in mind. These include, amongst others –⁴

- supporting developing countries by, for example, improving access to water, healthcare and high-quality education, protecting biodiversity and combating climate change;
- providing monetary support other than in the form of loans, that is, through grants; and
- promoting and ensuring that aid reaches least developed countries, which includes several African countries.

³ www.oecd.org/dac/financing-sustainable-development/development-finance-standards/official-development-assistance.htm [Accessed 1 August 2022].

⁴ www.afd.fr/en/actualites/8-things-know-about-official-development-assistance [Accessed 1 August 2022].

An ODA has three essential elements, namely, it –

- is undertaken by official agencies, being a state and local governments, or their executive agencies;
- promotes economic development and welfare as the main objective; and
- functions at concessional financial terms.

An ODA agreement gives rise to different consequences depending upon the nature of the assistance. It is essentially an assistance agreement in which the foreign country (the donor) (see 4.2.2) pledges to make economic, technical or other related assistance available to the beneficiary (see 4.2.2).

Countries that are eligible to receive ODA grants are listed by the DAC and are updated every three years. Most grants are provided by the 30 members of the DAC with the European Commission, and non-DAC countries provide around 20% of additional funding.

Official development assistance agreements support neglected sectors, for example, improving access to water, healthcare and high-quality education, protecting biodiversity and combating climate change. An ODA grant received is therefore used to reduce poverty and inequality, to increase economic growth, as well as to improve the living conditions of the underprivileged.⁵

Other less common forms of assistance under an ODA agreement may involve discounted loans that have to be repaid with interest, often at lower rates when compared to borrowing from commercial banks, or discounted technical services for which the foreign provider may receive compensation at less than market value. Technical services may include providing advice or skills in the form of specialist personnel, training and scholarships, grants for research, and associated costs that may accompany these services.

When a discounted loan or technical service is received, the foreign donor may receive partial compensation, unlike in the case of an outright grant in which case no repayment or compensation is required.⁶ Owing to the repayment obligations attached to the provision of a discounted loan, a small fiscal burden is placed on the donor.

4.1.2 Roles and responsibilities of some of the institutions involved in the official development assistance process

There are many parties that are involved in the ODA process in South Africa. Different entities are responsible for each aspect of the agreement that eventually allows for the effective management and fulfilment of the ODA agreement. It is beyond the scope of this Note to consider the involvement of different parties and entities in detail.

⁵ An example of an ODA agreement is the *Economic, Technical and Related Assistance Agreement between the Government of the United States of America and the Government of the Republic of South Africa* which was signed on 5 December 1995.

⁶ *Explanatory Memorandum on the Revenue Laws Amendment Bill, 2006.*

4.2 Entering into official development assistance agreements

4.2.1 Agreements entered into in pursuance of official development assistance

An ODA agreement is entered into between a foreign government and the government of South Africa. It therefore bears the stamp of the executive authority by virtue of section 231(3) of the Constitution.

An ODA agreement is generally an agreement that lists the duties and obligations of the contracting parties and also provides that the agency designated to carry out the activities of the ODA project is exempt from the payment of taxes. An exemption may then be applicable when these provisions in the ODA agreement are read with the sections of domestic law that specifically cater for these types of exemptions.

In addition to the ODA agreement, supplementary agreements may also be in place governing the relationship between the donor and the implementing agency (see **4.2.2**). These supplementary agreements will usually detail aspects such as the type of project to be undertaken, the details of the implementing agency that will undertake the project, the expectations of the implementation agency, time frames and allocation of funds, amongst others. Typical examples are improved access to water, healthcare, low-cost housing, and assistance to subsistent farmers in neglected areas. The ODA agreement and these supplementary agreements should therefore be considered together in determining the income tax implications.

4.2.2 The parties to an official development assistance agreement

There are usually various parties involved in the conclusion and operation of an ODA agreement.

This includes the –

- donor;
- beneficiaries of the grant; and
- implementing agency.

Donor

A foreign donor fulfils an important role in an ODA agreement. The foreign government is generally the donor and enters into an ODA agreement with the aim of providing assistance in the form of funds or services. The donor will usually provide the grant on the condition that it will be subject to a reduced rate or exempt from tax.

Most ODA agreements come from the members of the DAC, but the European Commission and non-DAC countries also provide ODA grants.

Beneficiaries

The beneficiaries of the grant are usually those that are most in need of financial assistance.⁷ In South Africa, for example, the beneficiaries will be the South African public in a specific area where the ODA project is undertaken.

⁷ www.un.org/esa/ffd/wp-content/uploads/2016/01/ODA_OECD-FfDO_IATF-Issue-Brief.pdf [Accessed 1 August 2022].

Implementing agency

The third party to an ODA agreement is the agency that is appointed by the donor to execute the functions under such agreement in the country that is receiving the grant, and would be the “person” referred to in the opening words of section 10(1)(yA). The implementing agency is responsible for fulfilling all the obligations of the agreement and for ensuring that the goals as agreed upon by the respective countries are accomplished.

The implementing agency appointed to execute the objectives of an ODA agreement can be either a foreign entity or a local entity.⁸ The implementing agency is sometimes also referred to as a contractor. In some instances, the implementing agency may appoint local contractors to execute certain aspects of the ODA project. In this case, the exemption under section 10(1)(yA) will not extend to the local contractors and the normal tax rules will apply (see **4.4.3**).

Provided that all the requirements of section 10(1)(yA) are met, the amount received by the implementing agency in consequence of the ODA agreement may be exempt.

4.3 The exemption contained in section 10(1)(yA)

An exemption from normal tax⁹ is allowed under section 10(1)(yA) –

- on any amount;
- received by or accrued to;
- any person designated by a foreign donor for goods or services provided to beneficiaries in carrying out the activities of the ODA project,

if the requirements listed in section 10(yA)(aa) and (bb) are met (see **4.4**).

This exemption applies to the extent that the amounts are received in consequence of a project that has been approved by the Minister¹⁰ and if the ODA agreement specifically states that the amount is exempt from normal (income) tax.¹¹ When considering whether an exemption exists for other taxes, for example, value-added tax and employees’ tax, the ODA agreement together with the applicable tax legislation should be considered. The ODA agreement does not necessarily have to be signed by the Minister as other national departments are also allowed to negotiate and enter into ODA agreements. The Minister must, however, approve the project to which the ODA agreement applies under section 10(1)(yA).

The words “to the extent” imply that it may be possible for part of the amount received by the person under an ODA agreement to not be in terms of an approved project or to not be specified as being exempt under the agreement. In these cases, an exemption will apply only with regard to the amount that meets all the requirements of section 10(1)(yA).

⁸ *Explanatory Memorandum on the Revenue Laws Amendment Bill, 20 of 2006.*

⁹ The term “normal tax” is defined in section 1(1) as “income tax referred to in section 5(1)”. Under section (1), income tax is payable annually on the taxable income received by or accrued to or in favour of a person.

¹⁰ Section 10(1)(yA)(aa).

¹¹ Section 10(1)(yA)(bb).

Should the exemption not apply to the full amount or to a portion of it, such amount received by or accrued to the person receiving the money must be included in gross income.¹²

Each ODA agreement has its own terms and conditions and should be analysed on its own to establish if it qualifies for the exemption.

If an ODA agreement does not specifically state that an exemption will be applicable on the payment of taxes, section 10(1)(yA) will not find application. Furthermore if, for example, the agreement provides for an exemption of only indirect taxes or only custom duties but makes no mention of normal tax, there will be no exemption for income tax purposes.

4.3.1 “Amount”

The word “amount” has been considered many times in various court cases. In *CIR v People’s Stores (Walvis Bay) (Pty) Ltd*,¹³ it was confirmed that income, although expressed as an “amount” in the definition of “gross income”, includes more than just money but may be every form of property that has a money value earned by the taxpayer. Every form of property includes corporeal and incorporeal property as well as debts and rights of action.

Therefore, if assistance by a donor is made to a person other than in the form of money, for example, in the form of services, such receipt or accrual will constitute an amount for purposes of “gross income”. The amount that should be included in gross income for such a type of receipt or accrual, is the monetary value attached to it. In determining the money value, an objective test must be applied as held in *C: SARS v Brummeria Renaissance (Pty) Ltd & others*.¹⁴ Such amount will qualify for an exemption if the requirements of section 10(1)(yA) are met.

4.3.2 “Received by or accrued to”

The words “received” and “accrued” are not defined in the Act but have received judicial consideration.

In *Geldenhuys v CIR*, Steyn J stated that the words “received by” must mean –¹⁵

“received by the taxpayer on his own behalf for his own benefit”.

In *CIR v Genn & Co (Pty) Ltd*, Schreiner JA stated the following:¹⁶

“It certainly is not every obtaining of physical control over money or money’s worth that constitutes a receipt for the purposes of these provisions. If, for instance, money is obtained and banked by someone as agent or trustee for another, the former has not received it as his income.”

¹² The term “gross income” is defined in section 1(1).

¹³ 1990 (2) SA 353 (A), 52 SATC 9 at 21.

¹⁴ 2007 (6) SA 601 (SCA), 69 SATC 205.

¹⁵ 1947 (3) SA 256 (C), 14 SATC 419 at 430.

¹⁶ 1955 (3) SA 293 (A), 20 SATC 113 at 123.

In *WH Lategan v CIR*, Watermeyer J stated the following on the meaning of “accrued”:¹⁷

“In his Lordship’s opinion the words in the Act ‘has accrued to or in favour of any person’ merely meant ‘to which he has become entitled’.”

Therefore, an amount received under an ODA agreement includes any amount received by an implementing agency on its own behalf and for its own benefit as well as those amounts that the agency is unconditionally entitled to but has not yet received (see **4.4.3** for more information on the exemption of the grant).

4.3.3 “Person”

For purposes of section 10(1)(yA), “person” refers to the implementing agency that has been designated to execute the ODA project. This person is designated to provide goods or services to beneficiaries according to the ODA project agreement.

A person can be a natural or juristic person, and includes in the definition of “person” in section 1(1) –

- an insolvent estate;
- the estate of a deceased person;
- any trust; and
- any portfolio of a collective investment scheme.

A foreign partnership is, however, excluded from the definition.

For purposes of section 10(1)(yA), the “person”, that is, the implementing agency receiving the amount under the ODA agreement, does not have to be a non-profit or tax-exempt entity.

See **4.2.2** for a discussion of the implementing agency, donor and beneficiaries.

4.4 Requirements to be met before an exemption is allowed under section 10(1)(yA)

In order for an exemption to be applicable under section 10(1)(yA), *all* the requirements of the section must be satisfied, namely –

- the ODA agreement must be binding under section 231(3) of the Constitution;
- the project must be approved by the Minister;¹⁸ and
- for agreements concluded on or after 1 January 2007,¹⁹ the ODA agreement must provide that the receipts and accruals are exempt from tax.²⁰

The burden of proving that the requirements of section 10(1)(yA) have been met, rests on the taxpayer.²¹

¹⁷ 1926 CPD 203, 2 SATC 16 at 20. The entitlement principle was confirmed in *CIR v People’s Stores (Walvis Bay) (Pty) Ltd* 1990 (2) SA 353 (A), 52 SATC 9 at 19.

¹⁸ Section 10(1)(yA)(aa).

¹⁹ See **4.3.3** for more information.

²⁰ Section 10(1)(yA)(bb).

²¹ Section 102(1)(a) of the Tax Administration Act 28 of 2011.

4.4.1 Official development assistance agreements and the Constitution

Section 10(1)(yA) requires that the ODA agreement must be binding under section 231(3) of the Constitution. An international agreement is binding in South Africa only after it has been approved by resolution in both the National Assembly and the National Council of Provinces.²²

In the event that the agreement –

- is of a technical, administrative or executive nature; or
- does not require either ratification²³ or accession;²⁴ and
- is entered into by the national executive,

section 231(3) of the Constitution provides that such agreement will bind South Africa without approval by the National Assembly and the National Council of Provinces.

These ODA agreements entered into by the national executive that comprises the President, the Deputy President, and the Cabinet ministers at national level do not need approval by Parliament.²⁵ The agreements must, however, be tabled in the National Assembly and the National Council of Provinces within a reasonable time.

An ODA agreement is considered as being the main source of financing for development aid by the DAC and can consist of grants or soft loans,²⁶ but excludes military aid, funds that promote a donor's security interests, and transactions that have a primarily commercial objective.²⁷ These agreements authorise the use of large sums of money and are therefore entered into by the national executive. Consequently, an ODA agreement falls within the ambit of section 231(3) of the Constitution.

4.4.2 Project details and approval by the Minister

Under section 10(1)(yA)(aa), each ODA project undertaken under an ODA agreement must be approved by the Minister. This means that it is not sufficient that the agreement only be confirmed as an ODA agreement, the project itself must also be approved by the Minister. Without this approval, an exemption will not apply.

An ODA agreement does not generally specifically state the nature and terms of the project. Rather, it broadly provides that economic, technical or related assistance will be provided by the foreign country and lists some of the privileges and immunities that will be enjoyed by the foreign government and the implementing agency.

²² Section 231(2) of the Constitution.

²³ *Lexico Dictionaries* defines "ratification" as "the action of signing or giving formal consent to a treaty, contract, or agreement, making it officially valid". www.lexico.com/en/definition/ratification [Accessed 1 August 2022].

²⁴ *Lexico Dictionaries* defines "accession" as "the formal acceptance of a treaty or agreement". www.lexico.com/en/definition/accession [Accessed 1 August 2022].

²⁵ <https://pmg.org.za/page/structure-of-government> [Accessed 1 August 2022].

²⁶ A "soft loan" is defined as "a loan with no interest or a below-market rate of interest". www.investopedia.com/terms/s/softloan.asp [Accessed 1 August 2022].

²⁷ www.oecd.org/dac/financing-sustainable-development/ [Accessed 1 August 2022]. See also 4.1.

Owing to the fact that many different types of projects can be executed under the framework of an ODA agreement, supplementary agreements are usually entered into that explicitly set out the particular project details as well as the details of the implementing agency. These supplementary agreements are not ODA agreements since they have not been entered into by the national executive or tabled before Parliament as required by section 10(1)(yA). They are instead entered into by the implementing agency and the foreign donor (see 4.2.1 for a discussion of the agreements). Even though the supplementary agreements are not ODA agreements, they are entered into as a result of an ODA agreement and the funds flowing from the supplementary agreements could qualify for exemption if the requirements are met.

Furthermore, the funds received must be used to execute the ODA project activities in South Africa. In the event that some of the funds are used for the benefit of beneficiaries outside South Africa, no exemption will apply. In this case, only the portion of income used in South Africa will be subject to the exemption under section 10(1)(yA).

Generally, the ODA agreement provides for the eventuality as to what should happen if there are still unspent ODA funds at the end of a financial year or upon the conclusion of the ODA project. If no such provision is made, the unspent funds must be returned to the Reconstruction and Development Fund at the end of each financial year.²⁸ The funds will then be carried over to the following financial year and can be requested again if needed.

4.4.3 Provision for exemption in the official development assistance agreement

Section 10(1)(yA)(bb) provides that the ODA agreement must contain a provision that declares that the amounts received by or accrued to the person executing the project are exempt from income tax.

Many ODA agreements were, however, drafted years ago and before the introduction of section 10(1)(yA). These agreements sometimes do not specifically state that the amounts received by or accrued to the person executing the project are exempt from income tax as required under section 10(1)(yA)(bb). As such, the grants received are often ineligible for an exemption, which deters donors from offering assistance in the form of ODA. In light of this difficulty, section 10(1)(yA)(bb) has consequently been amended.²⁹

For all ODA agreements entered into on or after 1 January 2007, such agreements must provide that the amounts received by or accrued to the person are exempt. For those agreements entered into before 1 January 2007, the requirement under section 10(1)(yA)(bb) will not apply and an exemption will be available irrespective of whether the agreement states that the grants are exempt or not.

This amendment is deemed to have come into operation on 1 January 2007 and applies in respect of years of assessment commencing on or after that date.

²⁸ Section 5 of the Reconstruction and Development Act 7 of 1994.

²⁹ Taxation Laws Amendment Bill [B27—2020].

Furthermore, an exemption will not be extended to the implementing agency (as the grant recipient) if the ODA agreement provides for an exemption only for the foreign donor and not the implementing agency. Similarly, taxpayers who desire to claim an exemption for income tax purpose will fall out of the ambit of section 10(1)(yA)(bb) if the ODA agreement does not provide for an exemption from normal tax. In other words, if the agreement provides for an exemption only from indirect taxes, this will not automatically extend to income tax.

In executing the project, the implementing agency may make use of the services of third-party contractors and service providers. The exemption under section 10(1)(yA) does not cover the receipts and accruals of these parties and the normal tax rules will thus apply to amounts received or accrued from the implementing agency.

Example – Satisfying the requirements of and claiming the exemption under section 10(1)(yA)

Facts:

South Africa and Country A enter into an ODA agreement under which Country A provides an ODA grant amounting to €900 000 to be used in projects relating to the erection of government subsidised housing in disadvantaged areas in South Africa.

The implementing agency designated by Country A to execute the ODA projects in South Africa is XYZ, a resident of Country A.

XYZ enters into subsequent contracts with service providers in South Africa such as building contractors and electricians to complete the building of the houses. The cost of the new houses equals €700 000. XYZ decides to use the remaining €200 000 to fund a separate project, unrelated to the ODA project in South Africa, in Country B.

The ODA agreement provides in clause 5 that South Africa shall exempt Country A from the payment of, or burden of, all import and export duties and other official charges, including value-added tax, on procurements financed by Country A under the ODA agreement.

Result:

a) ODA agreement confirmation and project approval

The National Treasury confirms that the agreement between South Africa and Country A is an ODA agreement and that the housing project was approved by the Minister as an ODA project. The requirement under section 10(1)(yA)(aa) is thus satisfied.

b) Exemption provided for in the ODA agreement

While clause 5 of the ODA agreement provides for exemptions for Country A in respect of indirect taxes (value-added tax) and other duties, the clause does not provide for an exemption from income tax. The requirement under section 10(1)(yA)(bb) is therefore not satisfied.

As the requirement in section 10(1)(yA)(bb) is not met, no exemption for income tax is available to the implementing agency XYZ.

c) Exemptions relating to the project in Country B and to the sub-contractors

No exemption would have been allowed on the €200 000 since this amount was not used on an ODA project executed in South Africa. Furthermore, this project would not have been approved by the Minister.

Since the exemption provision in the ODA agreement is applicable only to the implementing agency itself, the exemption under section 10(1)(yA) did not extend to the sub-contractors, that is, the building contractors and electricians. Normal tax rules thus applied to the sub-contractors.

4.4.4 The impact of other sections of the Act in relation to section 10(1)(yA)

(a) Section 23(n)

Section 23(n) is colloquially referred to as an “anti-double dipping” rule that provides that no deduction will be permissible on any deduction or allowance in respect of any asset or expenditure to the extent that –

- the amount is granted or paid to the taxpayer that is exempt from tax under section 10(1)(yA); and
- it is granted or paid for purposes of the acquisition of that asset or funding of that expenditure.

This means, for example, if a person receives an ODA grant that is used to acquire an asset or fund an expense and that grant is exempt under section 10(1)(yA), the person will not be allowed to claim a depreciation allowance on such asset or a tax deduction on the expense incurred.

(b) Paragraph 20(3)(c) of the Eighth Schedule to the Act

Under paragraph 20(3)(c) of the Eighth Schedule to the Act, the expenditure incurred by a person in respect of an asset in paragraph 20(1)(a) to (g) must be reduced by any amount that is exempt from tax under section 10(1)(yA), and is granted or paid for purposes of the acquisition of an asset.

The purpose of this provision is to prevent so-called double-dipping. Double-dipping occurs when a recipient of exempt income uses that exempt amount to purchase an asset, and then claims that amount as part of the base cost of the asset.³⁰

5. Conclusion

When claiming an exemption under section 10(1)(yA), the following conditions must be satisfied:

- The agreement must be an ODA agreement that is binding under section 231(3) of the Constitution.
- The ODA project must be approved by the Minister.
- The ODA agreement must stipulate that the agency designated by the donor is exempt from all taxes in South Africa.

³⁰ See the *Comprehensive Guide to Capital Gains Tax* on the **SARS website** for more information on capital gains tax in relation to section 10(1)(yA).

An exemption will be allowed only if all of the above requirements are met.

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