



*SOUTH AFRICAN REVENUE SERVICE*

**INTERPRETATION NOTE NO. 24**

DATE: 19 March 2004

**ACT : INCOME TAX ACT, 1962 (the Act)**  
**SECTION : SECTION 30(3)(b)(iv)**  
**SUBJECT : PUBLIC BENEFIT ORGANISATIONS (PBO): TRADING RULES**

**1. Purpose**

The purpose of this note is to explain the provisions of section 30(3)(b)(iv) of the Act which contain the trading rules for PBOs and to provide clarity with regard to the practical application thereof for public benefit organisations.

**2. Background**

It is generally accepted that most public benefit organisations voluntarily or involuntarily engage in business or trading activities. This may be to further the public benefit activities (PBAs) conducted by the PBO or form part of fund raising activities, letting of commercial property or the letting of facilities which are partially used to carry out PBAs.

Trading or the carrying on of a business undertaking by tax exempt organisations is a major cause for concern, as exempt entities should not be seen to be in competition with other tax paying entities, by either conducting the same or similar business activities in a tax-free environment, thereby undermining fair competition and potentially eroding the tax base. The main rule is therefore that PBOs are prohibited from carrying on business or trading activities.

It is, however, accepted that in certain circumstances the trading activities are so closely linked to conducting the PBAs, that they cannot be regarded as being in competition with the tax paying entities. Likewise, fund raising activities which take place on an occasional basis with voluntary assistance, cannot be regarded as being in competition with other tax paying entities. For this reason, the legislation provides for certain rules and parameters within which trading activities may be carried on by an exempt PBO. These provisions are contained in section 30(3)(b)(iv) of the Act.

### 3. The law

**Section 30(3) of the Act reads as follows:**

“(3) The Commissioner shall, for the purposes of this Act, approve a public benefit organisation which—

- (a) ...
- (b) has submitted to the Commissioner a copy of the constitution, will or other written instrument under which it has been established and in terms of which it is –
  - (i) ...
  - (ii) ...
  - (iii) ...
  - (iv) prohibited from carrying on any business undertaking or trading activity, otherwise than to the extent that—
    - (aa) the gross income derived from all such business undertakings or trading activities do not in total exceed the greater of—
      - (A) 15 per cent of the gross receipts of such public benefit organisation; or
      - (B) R25 000;
    - (bb) the undertaking or activity is—
      - (A) integral and directly related to the sole object of such public benefit organisation; and
      - (B) carried out or conducted on a basis substantially the whole of which is directed towards the recovery of cost and which would not result in unfair competition in relation to taxable entities;
    - (cc) the undertaking or activity, if not integral and directly related to the sole object of such public benefit organisation as contemplated in item (bb), is of an occasional nature and undertaken substantially with assistance on a voluntary basis without compensation; or
    - (dd) 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 purpose 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 out the undertaking or activity;”

### 4. General meaning of certain terminology

**Business** – has been described as anything which occupies the time, attention and labours of man for profit. Whilst there are no hard and fast rules in determining what is business, a number of factors will be taken into account, such as the intention, motive, frequency and the nature of the activity.

**Example 1**

The passive investment of funds in shares or loans is not normally regarded as carrying on a business. However, the financing of interest bearing loans to students, could be regarded as a business.

**Gross income** – is defined in section 1 of the Act and in respect of a resident, includes the total amount in cash or otherwise received by or accrued to or in favour of such resident, but excludes receipts or accruals of a capital nature.

**Example 2**

The **gross income** of a PBO would include the total amount received from school fees, accommodation, sale of second hand clothing, fund raising activities, rent, investment income, but would exclude grants, proceeds from the sale of capital assets and bequests.

**Gross receipts** – includes the total sum of all receipts and accruals from any source, irrespective of whether on capital or revenue account.

**Example 3**

The **gross receipts** of a PBO would include the gross income received from all sources such as donations, subsidies, school fees, rent, accommodation charges, fund-raising activities, investment income, sale of capital assets, bequests and investment income.

**Related trade** – the trading activity must be directly connected, linked and associated with the approved PBA which is conducted by the PBO.

**Substantially the whole** – In the strict sense this concept is regarded by SARS as being 90% or more. However, in order to conform to the provisions of section 30 and to overcome certain practical difficulties, SARS will accept a percentage of not less than 85%.

**Trade** – is defined in section 1 of the Act and includes every profession, trade, business, employment, calling, occupation, venture, letting of property and the use of or the grant of permission to use a patent, trademark or copyright.

**Unrelated trade** – is regarded as not being associated with, is unconnected and conducted independently from the approved PBA of the PBO.

## 5. Application of the law

In terms of the new legislation, PBOs are entitled to carry on business or trading activities within specific parameters. There are four categories where the trading activities of a PBO will not affect its tax-exempt status. Each category has its own conditions and requirements.

As regards the first category (section 30(3)(b)(iv)(aa)), where a PBO carries on more than one trading activity the *de minimus* rule is applied on a combined basis, and not to each trade separately.

Item (bb) - (related trade), (cc) - (unrelated trade) and (dd) - (Ministerial approval), are applied separately to each trading activity.

**Example 4**

A PBO provides accommodation to aged persons and receives income from the following sources:

- (a) Accommodation charges
- (b) Rent for use of hall
- (c) Annual fête
- (d) Sale of Christmas Cards
- (e) Investment income
- (f) Bequest
- (g) Donations

The *de minimis* rule (aa) is applied collectively to the total income derived from all the trading activities.

The related trade, (bb), unrelated trade (cc), and Ministerial approval (dd) rules are applied separately to each trading activity.

**5.1 The *de minimis* rule (item (aa))**

An organisation may carry on business or trading activities if it is on a very small scale in relation to its other activities. Business or trading activities will be acceptable in these circumstances if the gross income from **all** business or trading activities of the organisation is less than the greater of 15% of the gross receipts of the organisation, or R25 000. It is irrelevant to what extent a profit is derived from the trading activities.

**Example 5**

A religious institution could sell books at a profit or a school let its hall to outside parties provided the total receipts from **all** trading activities carried on by the organisation do not exceed the 15% or R25 000 limitation.

**Example 6**

ABC Charity runs a soup kitchen for homeless people, and in order to augment its income, it runs a butchery.

Donations received	R100 000
Butchery income (gross)	R50 000
Interest income	<u>R100 000</u>
Gross receipts	<u>R250 000</u>

In terms of this provision, gross income from trading may be 15% of the gross receipts. This means that the gross income from trading for this PBO may not exceed R37 500. This PBO would either forfeit its exempt status or have to divest itself of the trading activity if the gross income from trading exceeds this level.

## 5.2 Related trade (item (bb))

Two requirements must be complied with:

- The trading or business activity must be integral and directly related to the sole object of the PBO.

### **Example 7**

Student fees charged by an educational institution, residential fees received by an old age home, accommodation fees charged by a hostel, would be regarded as trade income which is directly related to the object of the PBO.

- Substantially the whole of the trading activity must be conducted on a cost recovery basis and will not result in unfair competition with other tax paying entities.

### **Example 8**

Tuck shop at a school; fees charged by a hospice.

## 5.3 Unrelated trade (item (cc))

To qualify under this item the trading activity must be–

- of an occasional nature; and
- undertaken substantially with assistance on a voluntary basis without compensation.

### **Example 9**

Unrelated activities which are not frequently undertaken, and which take place with voluntary assistance will include fundraising activities such as fêtes, cake sales, raffles and sponsored golf events.

## 5.4 Ministerial approval (item (dd))

The Minister may approve a specific undertaking or activity by notice in the *Gazette*, taking into account the following–

- the scope and benevolent nature of the undertaking or activity;
- the direct connection and interrelationship of the undertaking or activity with the sole purpose of the PBO;
- the profitability of the undertaking or activity; and
- the level of economic distortion that will be caused by the carrying on of the undertaking or activity by a tax-exempt body.

Any submissions in this regard will have to clearly demonstrate and motivate the benefits of the activity for the general public, together with reasons why it will not result in unfair competition with other taxpayers, or erode the tax base. To date, no such activities have been approved by the Minister.

## 6. Practical application of trading rules

6.1 The main rule in terms of section 30 is that when the PBO relies on the *de minimus* trading rule set out in section 30(3)(b)iv(aa), the gross income of **all** the trading activities must be pooled to determine whether the PBO falls within the 15% or R25 000 threshold. It follows that in such circumstances the PBO cannot, in addition to the *de minimus* rule, also rely on some of the other paragraphs, i.e. the related trade or unrelated trade rules, provided for in this subsection.

### Example 10

An institution providing approved educational PBAs, receives the following income:

	R
(a) School Fees (Qualifies under 5.2)	13 500 000
(b) Aftercare Income (Qualifies under 5.2)	350 000
(c) Hiring of Facilities (Trade Income)	50 000
(d) Uniform Shop (Qualifies under 5.2)	40 000
(e) Tuck Shop (Qualifies under 5.2)	600 000
(f) Fundraising (Qualifies under 5.3)	80 000
(g) Other (non-trade) Income	380 000
Gross receipts	<u>15 000 000</u>
15% of gross receipts	<u>2 250 000</u>
Gross income from trading activities	<u>14 620 000</u>

The PBO will not qualify for exemption in terms of the *de minimus* rule.

6.2 It is, however, recognised that this rule could have harsh consequences for some PBOs. To alleviate this, the rule will be administratively relaxed under certain circumstances, depending on the specific nature of the case. Where a PBO relies on the related trading and/or unrelated trading rule, the PBO will be allowed to also access the *de minimus* rule up to the greater of 5% of the gross receipts of the PBO or R25 000, **provided the trading activities are incidental and are not conducted on a commercial basis resulting in unfair competition.**

### Example 11

An institution providing approved educational PBAs, receives the following income:

	R
(a) School Fees (Qualifies under 5.2)	13 500 000
(b) Aftercare Income (Qualifies under 5.2)	350 000
(c) Hiring of Facilities (Trade Income)	50 000
(d) Uniform Shop (Qualifies under 5.2)	40 000
(e) Tuck Shop (Qualifies under 5.2)	600 000
(f) Fundraising (Qualifies under 5.3)	80 000
(g) Other (non-trade) income	380 000
Gross receipts	<u>15 000 000</u>
5% of gross receipts	<u>750 000</u>
Gross income from trading activities	14 620 000
Less: Activities qualifying under items (bb), (cc) or (dd)	<u>14 570 000</u>
	<u>50 000</u>

The PBO may not derive income from trading activities which exceeds the greater of: (A) R750 000 or (B) R25 000.

The PBO will qualify for exemption in terms of the trading provisions as the gross receipts from "non-qualifying" trading activities = R50 000.

**6.3** Trading activities which are conducted on a commercial basis resulting in unfair competition will not be acceptable.

**Example 12**

An orphanage caring for abandoned children also operates a service station to augment its income. The following income is received:

	<b>R</b>
(a) Donations and grants	1 200 000
(b) Fundraising activities (Qualifies under 5.3)	100 000
(c) Service Station (Trade Income)	<u>300 000</u>
Gross receipts	<u>1 600 000</u>

The PBO will not be entitled to apply the administrative concession as described in paragraph 6.2, as the trading activity is not regarded as being incidental and is conducted on a commercial basis resulting in unfair competition.

**7. Conclusion**

The flexible approach to the application of the trading requirements is merely an administrative measure that is being put in place until the relevant legislation has been reviewed and amended appropriately or this note is withdrawn or amended.

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