

INTERPRETATION NOTE: 24 (Issue 4)

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ACT : INCOME TAX ACT 58 OF 1962
SECTION : SECTION 10(1)(cN)
SUBJECT : PUBLIC BENEFIT ORGANISATIONS: TRADING RULES – PARTIAL TAXATION OF TRADING RECEIPTS

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Preamble

In this Note unless the context indicates otherwise –

- “**PBA**” means any public benefit activity listed in Part I of the Ninth Schedule;
- “**PBO**” means a public benefit organisation as defined in section 30(1) and approved by the Commissioner under section 30(3);
- “**Schedule**” means a Schedule to the Act;
- “**section**” means a section of the Act;
- “**TA Act**” means the Tax Administration Act 28 of 2011;
- “**the Act**” means the Income Tax Act 58 of 1962; and
- any word or expression bears the meaning ascribed to it in the Act.

All guides, interpretation notes and rulings referred to in this Note are available on the SARS website at www.sars.gov.za. Unless indicated otherwise the latest issue of these documents should be consulted.

1. Purpose

This Note provides guidance on the interpretation and application of section 10(1)(cN), which provides for the exemption from income tax of the receipts and accruals of a PBO other than receipts and accruals derived from certain business undertakings or trading activities.

2. Background

Section 10(1)(cN) was amended in 2006 to allow for a partial taxation system for PBOs. A PBO may therefore carry on limited business undertakings or trading activities provided its sole or principal object remains the carrying on of one or more PBAs.¹

3. The law

Section 10(1)(cN)

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

- (cN) the receipts and accruals 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 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 out 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;

¹ See *Tax Exemption Guide for Public Benefit Organisations in South Africa* for further information as well as the general guidance on the approval and taxation of PBOs.

4. General meaning of certain terminology in the context of section 10(1)(cN)

4.1 Basic exemption

The amount which is determined as a threshold is applied to the total receipts and accruals during a year of assessment derived from a business undertaking or trading activity not qualifying for a specific exemption (see **6.1**, **6.2** and **6.3**). The basic exemption is calculated as an amount equal to the greater of 5% of the total receipts and accruals of the PBO during the relevant year of assessment or R200 000 (see **6.4** and **Example 12**).

4.2 Business undertaking

The term “business” is not defined in the Act. Based on case law, it is generally accepted to include anything occupying the time, attention and labours of a person for profit. There are no hard and fast rules in determining what constitutes business. However, in determining whether a business undertaking is being carried on a number of factors may be taken into account such as the intention, motive, frequency and nature of the activity.

The passive investment of surplus funds in shares or an investment in a financial institution is not normally regarded as a business undertaking or trading activity. However, the advancing of interest-bearing loans at market-related rates by a money lender would be regarded as a business undertaking.

4.3 Integral and directly related

The business undertaking or trading activity must be integral and directly related to the PBA carried on by the PBO.

Example 1 – Integral and directly related

Facts:

A PBO conducts a PBA of providing healthcare services at no charge to poor and needy persons. In addition to providing a medical consultation service, the PBO also provides medication at cost.

Result:

The provision of medication at cost is regarded as integral and directly related to the activity of providing healthcare services to poor and needy persons.

4.4 Occasional nature

A business undertaking or trading activity of an occasional nature is one conducted on an irregular, infrequent basis or as a special event.

Example 2 – Examples of business undertakings or trading activities of an occasional nature

Activities of an occasional nature may include –

- annual jumble sales at which donated second-hand clothing is sold;
- annual fundraising events such as fêtes, cake sales or the sale of raffle tickets involving prizes that have been donated;

- charity golf days involving donated or sponsored prizes;
- a gala dinner held to raise funds; or
- the sale of Christmas cards reconditioned by volunteers.

4.5 Recovery of cost

A business undertaking or trading activity will be regarded as having been carried out on a basis substantially the whole (see 4.7) of which is directed towards the recovery of cost when goods are not sold to maximise profits but rather with the intention of recovering direct and reasonable indirect costs. It is not always possible to base trading activities on a 100% cost-recovery basis and it is for this reason that legislation requires that substantially the whole of the business undertaking or trading activity must be based on recovery of cost.

Example 3 – Recovery of cost

Facts:

A PBO carries on a PBA under the heading “Education and Development” and operates a tuck shop serving and selling refreshments to learners for a consideration which is determined by taking into account the cost of the goods. Assistance in the tuck shop is provided by volunteers. The cost of the goods sold includes the purchase price, costs such as telephone, electricity, repairs and maintenance, stationery, cleaning materials, and an amount for a reserve created for future replacement costs of capital assets such as a refrigerator, microwave, and deepfreeze. As a result of the voluntary assistance, no salaries or wages are incurred and a small profit may result which is used by the PBO to fund its PBAs.

Result:

The running of the tuck shop is regarded as being carried out or conducted on a basis substantially the whole of which is directed towards the recovery of cost.

4.6 Sole or principal object

The word “principal” is used in conjunction with the word “sole” and the concept means that the sole or predominant object must be the carrying on of one or more PBAs. A PBO cannot have more than one sole or principal object.

Example 4 – Sole or principal object

Facts:

An organisation carries on a commercial business activity of a supermarket and is open seven days a week. Some of the stock-in-trade is used to provide free meals to homeless people on a regular basis.

Result:

The organisation’s sole or principal object is not to provide meals to homeless people but to conduct a commercial trading activity.

4.7 Substantially the whole

Although the expression “substantially the whole” is used in various sections it is not defined in the Act. In Binding General Ruling 20 “Interpretation of the Term ‘Substantially the Whole’ ” it is stated that “substantially the whole” is regarded by SARS to mean 90% or more. PBOs, however, operate in an uncertain environment which makes proper planning difficult therefore in these circumstances SARS accepts a percentage of not less than 85%.

Example 5 – Substantially the whole of the activity undertaken on a cost-recovery basis

Facts:

A PBO provides literacy and numeracy education to adults. In order to fund the provision of these PBAs, the PBO charges tuition fees. The fees are based on the estimated cost to the PBO in providing the tuition which includes the cost of hiring a hall, tuition material and text books. The tuition is provided on a voluntary basis by teachers after hours. The tuition fee is the principal source of income for the PBO.

Result:

Since the tuition fees are determined on a cost-recovery basis and no charge is made for the donated services of the teachers, substantially the whole of the PBAs are regarded as being directed towards the recovery of cost.

4.8 Substantially with assistance on a voluntary basis

Any assistance must predominantly be undertaken on a voluntary basis, without compensation.

Example 6 – Substantially with assistance on a voluntary basis

Facts:

At a school fête each of the 20 classes are assigned to run a stall selling donated goods in order to raise funds. All the stalls are manned by volunteers who include teachers, parents and learners.

Result:

All the assistance given to the school at the fundraising event is provided on a voluntary basis.

4.9 Total receipts and accruals

Section 10(1)(cN) exempts from income tax the “receipts and accruals” of a PBO to the extent that they are derived in the manner specified in the subsection. The type of receipt or accrual envisaged is one which is included in the definition of “gross income”.² Thus, receipts or accruals of a capital nature which are not deemed to be included in gross income would not be included in the receipts and accruals referred to in the opening words of section 10(1)(cN) since they do not require exemption. Receipts or accruals of a capital nature are taken into account in determining a taxable capital gain which is included directly in taxable income. While a taxable

² The term “gross income” is defined in section 1(1).

capital gain is potentially subject to income tax, the exemptions in section 10 do not apply to it because a taxable capital gain is not a receipt or accrual. Paragraph 63A of the Eighth Schedule contains the rules for disregarding capital gains and losses of a PBO (see 14).

Example 7 – Examples of “total receipts and accruals”

The total receipts and accruals of a PBO will include the total or gross amount received or accrued from all sources, whether of a capital nature or not, such as donations, subsidies, school fees, rent, accommodation charges, fundraising activities, investment income, the sale of movable and immovable assets and bequests.

4.10 Trading activity

The term “trade” is defined in section 1(1) 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, trade mark or copyright. The courts have interpreted trade to be neither exhaustive nor restrictive and will include any activity involving risking something with the object of making a profit. Each case will, however, be determined on its own merits.

Example 8 – Examples of trading activities

Trading activities include the letting of property, conducting farming activities, providing professional services and the grant of permission to use a copyright or patent.

4.11 Unfair competition

A PBO should not be in a more favourable position or have an unfair advantage over a taxable entity conducting the same business undertaking or trading activity in that the PBO is not required to sacrifice a portion of its profit in the form of tax. Each case will be considered on its own merits in determining whether a PBO has such an unfair advantage.

Example 9 – Unfair competition

Facts:

An orphanage caring for abandoned children also operates a service station with the intention of earning a profit to augment its income.

Result:

The operation of the service station is a commercial trading activity which will result in unfair competition with other taxpaying entities.

5. Application of the law

Section 10(1)(cN) provides that the receipts and accruals of a PBO are exempt from normal tax, other than from any business undertaking or trading activity falling outside four exemption categories.

A PBO is permitted to carry on business undertakings or trading activities provided the sole or principal object remains the carrying on of PBAs. A PBO may not engage in commercial trading activities with the intention of earning a profit and claim that since a portion of the profits are used to carry on PBAs, it should qualify for approval as a PBO. The requirements and conditions of section 30 must continue to be complied with.

Receipts and accruals that arise from a business undertaking or trading activity will only be exempt from tax if they fall within one of the four categories of exemption included in section 10(1)(cN). These four categories are dealt with in **6**.

The receipts and accruals derived from the four categories of business undertakings or trading activities in **6.1**, **6.2**, **6.3** and **6.4** are exempt from normal tax. Each category of exemption has its own conditions and requirements and is applied separately.

There is no limit on the amount of receipts and accruals which are exempt from normal tax under the exemptions in **6.1**, **6.2** and **6.3**. There is, however, a limitation on the amount of the basic exemption discussed in **6.4**.

6. Categories of business undertakings or trading activities

6.1 Integral and directly related trade

In order to qualify for this exemption –³

- the business undertaking or trading activity must be integral and directly related (see **4.3**) to the sole or principal object (see **4.6**) which is the PBA carried on by the PBO;
- substantially the whole (see **4.7**) of the business undertaking or trading activity must be conducted on a cost-recovery basis (see **4.5**); and
- the business undertaking or trading activity should not result in unfair competition with other taxable entities (see **4.11**).

Example 10 – Trade integral and directly related to sole or principal object

Facts:

A PBO engages in PBAs of caring for disabled persons. As a therapeutic and remedial activity the PBO has acquired land on which the residents are taught to grow vegetables and care for a small herd of cattle.

³ Section 10(1)(cN)(ii)(aa).

The mechanical labour as well as veterinary services are provided at no cost by a nearby agricultural college. All the manual labour is undertaken by the residents. The produce is primarily used for own consumption and any surplus is sold to a local farmers' market to defray costs. Some of the residents have been taught to knead and bake bread which is supplied to a nearby supermarket. No commercial ovens or baking processes are used. Both the farming and baking activities are regarded as being of therapeutic benefit for the residents.

Result:

The trading activities are integral and directly related to the sole object of the PBO which is to care for disabled persons. The primary purpose of the activities is to provide for the consumption of the residents and only the excess produce is sold in order to recover costs. Secondly, the activities are regarded as being of therapeutic benefit to the residents who are unable to find employment in the open labour market.

Substantially the whole of the trading activities are conducted on a cost-recovery basis. If it were not for the donated services or if external labour had been hired, a profit would not have been realised.

The activities do not result in unfair competition with other taxpaying entities.

Note:

The use of assets to generate income, for example, by the letting of parking facilities, tennis courts or a hall, to members of the public, will not be regarded as a related trading activity but as income from a taxable trading activity.

6.2 Occasional trade

In order to qualify for exemption as an occasional trade the business undertaking or trading activity must –⁴

- take place on an occasional or infrequent basis (see 4.4); and
- be undertaken substantially with assistance on a voluntary basis without compensation, other than the *bona fide* reimbursement of reasonable and necessary out-of-pocket expenditure (see 4.8).

Example 11 – Examples of occasional trade with voluntary assistance

Fundraising activities such as fêtes, cake sales, raffles and jumble sales which take place on an annual basis with the assistance of helpers or volunteers who are not compensated for their services.

⁴ Section 10(1)(cN)(ii)(bb).

6.3 Ministerial approval

A business undertaking or trading activity may be approved by the Minister of Finance by notice in the *Government Gazette* by taking into account the –⁵

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

Any submission in this regard must clearly demonstrate and motivate the benefits of the business undertaking or trading activity for the general public, together with reasons why it will not result in unfair competition with other taxable entities, or erode the tax base.

6.4 Basic exemption

A PBO carrying on business undertakings or trading activities which do not fall within the ambit of the permissible exemptions set out in **6.1**, **6.2** and **6.3** will, subject to the basic exemption, be taxed on the receipts and accruals derived from all such other business undertakings or trading activities. The greater of 5% of the total receipts and accruals of the PBO or R200 000 will be deducted from those receipts and accruals.⁶

Example 12 – Basic exemption

Facts:

A PBO conducts PBAs from a property it owns. In order to augment its income, it lets a portion of the property not used for carrying on the PBAs.

The PBO's total receipts and accruals for the year ended 28 February 2017 are as follows:

	R
Donations	450 000
Rental income	90 000
Interest income	<u>50 000</u>
Total receipts and accruals	<u>590 000</u>

Result:

The basic exemption is calculated as an amount equal to the greater of 5% of the total receipts and accruals or R200 000.

5% of the total receipts of R590 000 amounts to R29 500.

The total receipts from letting the property (R90 000) will be exempt as the PBO receives the benefit of the greater of R29 500 or R200 000.

⁵ Section 10(1)(cN)(ii)(cc).

⁶ Section 10(1)(cN)(ii)(dd).

7. Practical application of the basic exemption

7.1 Determination of the basic exemption threshold

The total receipts and accruals derived from all business undertakings or trading activities not qualifying for exemption (see **6.1**, **6.2** and **6.3**) must be added together before the deduction of the basic exemption. This means that the value of the basic exemption threshold must be applied collectively to the total receipts and accruals from all commercial business undertakings or trading activities and not individually to each such undertaking or activity.

In the case of an approved regulating or co-ordinating body of a group of PBOs,⁷ the total receipts and accruals of all the individual PBOs within the group as reflected in the consolidated financial statements will be taken into account in calculating the 5% of the total receipts and accruals. The amount of R200 000 is not increased by the number of individual organisations within the group, as this amount is applicable to a PBO, which in this case is the regulating or co-ordinating body.

7.2 Apportionment of expenditure

Expenditure directly incurred in the production of a specific category of income must be allocated to such income. Expenditure paid as a single amount relating to non-exempt income and income from PBAs must be apportioned *pro rata* between these two categories. The basis of apportioning an expense will depend on the nature of the expense.

General expenditure incurred, such as accounting fees, audit fees, bank charges or overhead expenses, not specifically relating to a particular source of income but which can be attributed to various sources, must be apportioned on a *pro rata* basis by applying the ratio that a particular source of receipts and accruals bears to the total receipts and accruals derived by the PBO (see from Step 5 in **Example 13** in the **Annexure**).

Note:

If a PBO has maintained accurate records of expenditure relating to particular sources of income it will be unnecessary for it to allocate the expenditure on a *pro rata* basis.

7.3 Allowable deductions

Expenditure incurred in the production of income is generally allowable as a deduction in determining taxable income to the extent that it meets the requirements of the Act. Expenditure of a capital nature (such as the cost of acquiring the business) and expenditure incurred which produces exempt income is not allowed as a deduction in determining taxable income.

An equitable allocation must be made when expenditure is incurred with a dual intent, namely, for purposes of trade as well as to carry on PBAs. Such an allocation is necessary in order to exclude from deduction the portion of expenditure incurred in the production of exempt income.

⁷ See section 30(3A).

8. Income from a trust of which a public benefit organisation is a beneficiary

A PBO may be a beneficiary of a trust. Generally income received by or accrued to a trust during a year of assessment is deemed to accrue to its beneficiary when the beneficiary acquires a vested right to such income during that year of assessment, including the acquisition of such a right through the exercise of the trustees' discretion.⁸

To the extent that an amount is not deemed to accrue to a beneficiary it is deemed to accrue to the trust.⁹

It follows that a PBO that is a beneficiary of a trust must account for any income vested in it during the year of assessment.

A distribution received by a PBO from a trust which is generated from a trading activity, such as rental income or income derived from the operation of a commercial bookshop, retains its character and will be deemed to be a receipt or accrual from a business undertaking or trading activity derived by the PBO. The receipt will qualify to be taken into account in the determination of the basic exemption of the PBO (see **Example 14** in the **Annexure**).

9. Losses incurred

A profit or loss arises from the final result of a trading operation after allowable expenditure has been deducted. Expenditure and losses which are not of a capital nature and which are actually incurred in the production of income, may be deducted under section 11(a) in the determination of taxable income.

An "assessed loss" as defined in section 20(2) arises when the deductions admissible under section 11 exceed the income against which they are so admissible. A balance of assessed loss determined in a previous year of assessment may be carried forward from the preceding year of assessment for set-off against the income derived in the current year of assessment.

Note:

In the case of a company, an assessed loss may not be carried forward or set-off in the next succeeding year of assessment unless the company has carried on a "trade" as defined in section 1(1). See Interpretation Note 33 "Assessed Losses: Companies: The 'Trade' and 'Income from Trade' Requirements". This Note applies to PBOs that are companies and not to PBOs that are registered as trusts.

⁸ Sections 25B(1) and (2).

⁹ Section 7(7) contains an exception to this rule when the income of the trust has been funded by a donation, settlement or other disposition. When section 7(7) applies the income will be deemed to accrue to the trust donor.

10. Wear-and-tear or depreciation allowance on assets

Section 11(e) provides for the deduction of a wear-and-tear or depreciation allowance on certain qualifying assets. The allowance is claimed over the useful life of the asset concerned and will only be allowed to the extent that the asset is used for the purposes of trade. The allowance must be apportioned for an asset that has not been used throughout the year of assessment for the purposes of trade, for example, in the year of assessment in which an asset is acquired, disposed of or ceases to be used.

The allowance may be claimed proportionately on an asset that is used by a PBO partly for trade and partly for conducting PBAs. Only the portion of the allowance that is attributable to the PBO's trade usage will qualify for deduction.

An asset may have been used by a PBO in a previous year of assessment during which its receipts and accruals were fully exempt from income tax. The PBO may later become taxable on its business undertakings or trading activities in the current year of assessment as a result of its income from such undertakings or activities exceeding the basic threshold exemption. The use of the asset during the period when the PBO was fully exempt from income tax must be taken into account in determining the amount by which the value of the asset has diminished.

For more information on the application and interpretation of section 11(e) as it relates to the determination of the value of an asset on which the allowance is based and acceptable write-off periods, see Interpretation Note 47 "Wear-and-Tear or Depreciation Allowance".

11. Period for which accounts are to be submitted

A PBO that is registered as a trust will have a year of assessment ending on the last day of February. However, under section 66(13A) a trust can apply for permission to draw up its financial statements to a different closing date if it would be more convenient for it to do so. For more information see Interpretation Note 19 "Year of Assessment of Natural Persons and Trusts: Accounts Accepted to a Date Other Than the Last Day of February".

A PBO that is a non-profit company as defined in section 1 of the Companies Act 71 of 2008, as well as an association¹⁰ of persons established under a constitution or any other written instrument will have a year of assessment ending on the date that coincides with its financial year-end. For more information see Interpretation Note 90 "Year of Assessment of a Company: Accounts Accepted to a Date Other Than the Last Day of a Company's Financial Year".

12. Rate of tax

A PBO that is liable to tax on receipts and accruals not qualifying for exemption will pay tax at rate of 28% on its taxable income, irrespective of whether it is established as a trust, non-profit company or as an association of persons.

¹⁰ See paragraph (d) of the definition of "company" in section 1(1).

13. Provisional tax

A PBO is exempt from making provisional tax payments.¹¹ Any liability to income tax on taxable income will become payable on assessment.

14. Capital gains tax

Capital gains and losses on the disposal of assets are determined under the Eighth Schedule. Under section 26A a person must include in taxable income the amount of any taxable capital gain determined under the Eighth Schedule.

A PBO must disregard any capital gain or capital loss made on the disposal of certain categories of assets under paragraph 63A of the Eighth Schedule. Comprehensive information and guidance on the application and interpretation of paragraph 63A relating to the disposal of assets by PBOs is dealt with in Interpretation Note 44 “Public Benefit Organisations: Capital Gains Tax”. Also see *Comprehensive Guide to Capital Gains Tax*.

15. Transfer duty

Transfer duty will become payable on a property which qualified for an exemption from transfer duty if the whole of the property or substantially the whole of that property is used for purposes other than the carrying on of any PBA. The transfer duty becomes payable at the time the property is used for any purpose other than for the purpose of carrying on one or more PBAs. For more information in this regard see Interpretation Note 22 “Transfer Duty Exemption: Public Benefit Organisations and Institutions, Boards or Bodies”.

16. Reporting requirements and compliance**16.1 Record-keeping**

All PBOs are required to keep records for five years from the date of the submission of a return¹² under the TA Act¹³ and no longer four years¹⁴ as previously required under the Act. Although records are generally required to be kept and retained for five years, there are, however, circumstances in which it may be required to be retained for a longer period.¹⁵ For example, if –

- no return is submitted for a tax period but is required to be submitted, records, books of account or documents must be kept and retained indefinitely until the obligation to submit a return has been complied with, and then for five years from the date of submission of the return;

¹¹ See paragraph (aa) of the exclusions to the definition of a “provisional taxpayer” in paragraph 1 of the Fourth Schedule.

¹² The term “return” is defined in section 1 of the TA Act and includes any form, declaration, document or other manner of submitting information to SARS that incorporates a self-assessment or is the basis on which an assessment is to be made by SARS.

¹³ Section 29(3) of the TA Act.

¹⁴ Section 3 and section 4 of the Tax Administration Laws Amendment Act 44 of 2014 amended and repealed section 18A(4) and section 30(9), respectively. These amendments came into operation on 20 January 2015.

¹⁵ Section 32 of the TA Act. See *Short Guide to the Tax Administration Act, 2011 (Act No. 28 of 2011)*.

- an objection or appeal against an assessment or decision is lodged the records, books of account or documents relevant to the objection or appeal must be kept and retained until the disputed assessment or decision becomes final or the applicable five-year period has elapsed, whichever is the later; or
- a person is notified of, or is aware of an audit or investigation by SARS the records, books of account or documents relevant to that audit or investigation must be retained until it is concluded or the applicable five-year period has elapsed, whichever is the later.

A person who wilfully and without cause fails or neglects to retain records as required is guilty of an offence and on conviction is subject to a fine or imprisonment for a period not exceeding two years.¹⁶

16.2 Income tax returns

A PBO must submit income tax returns, even if its approval or exemption results in no tax liability. The income tax return enables the Commissioner to annually assess whether the PBO is operating within the prescribed limits of its approval and to determine whether the partial taxation principles have been applied to receipts and accruals derived from a business undertaking or trading activity not qualifying for exemption.

The prescribed Income Tax Return for Exempt Organisations (IT12EI) applicable to PBOs must be submitted on an annual basis. It may be obtained from –

- the eFiling website **www.sarsefiling.co.za**;
- the Tax Exemption Unit;
- any SARS branch office; or
- the SARS National Contact Centre at 0800 00 7277.

For assistance on how to complete the income tax return see *How to complete the Return of Income: Exempt Organisations (IT12EI return)*.

A return must be a full and true return¹⁷ and be signed by the PBO or by the PBO's duly authorised representative. The person signing the return will be regarded as being cognisant of the statements made in the return.¹⁸

Non-receipt of an income tax return does not affect the obligation to submit an income tax return.¹⁹ A person who wilfully and without cause refuses or neglects to submit a return or document to SARS is guilty of an offence and on conviction is subject to a fine or imprisonment for a period not exceeding two years.²⁰

16.3 Supporting documentation

It is not a requirement for supporting documents to be submitted together with the income tax return. The PBO will be notified if supporting documentation is required to substantiate any aspect of the income tax return.

¹⁶ Section 234(e) of the TA Act.

¹⁷ Section 25(2) of the TA Act.

¹⁸ Section 25(3) of the TA Act.

¹⁹ Section 25(4) of the TA Act.

²⁰ Section 234(d) of the TA Act.

A PBO whose income tax return is supported by any balance sheet, statement of assets and liabilities or account prepared by any other person may be requested to submit a certificate or statement recording –²¹

- the extent of the examination by the preparer of the books of account and of the documents from which the books of account were prepared; and
- in so far as may be ascertained by the examination, whether the entries in those books and documents disclose the true nature of any transaction, receipt, accrual or payment or debit.

The accounts must be signed by a person responsible for the PBO in a fiduciary capacity and by the person who prepared them on behalf of the PBO.

17. Objection and appeal

A PBO may object to an assessment within 30 days from the date of the assessment.²² The objection must be made on the prescribed form and specify in detail the grounds on which it is made. SARS will consider the objection and may disallow the objection or allow the objection in whole or in part.

If on disallowance of the objection the PBO is dissatisfied with the decision by SARS it may appeal against the disallowance. Such appeal must be made on the prescribed form and lodged with SARS within the prescribed period.

Chapter 9 of the TA Act provides the legal framework for these disputes which must be read together with the rules for objections and appeals.²³ For more information on the resolution of tax disputes see *Dispute Resolution Guide: Guide on the Rules Promulgated in terms of Section 103 of the Tax Administration Act, 2011* and *Alternative Dispute Resolution: Quick Guide*. The SARS website should be consulted to determine which of the prescribed forms must be submitted in order for an objection or an appeal to be valid.

18. Conclusion

This Note discusses only the broad principles in interpreting the legislation. Since the facts and circumstances pertaining to each PBO may differ, each case must be considered on its own merits.

Legal Counsel

SOUTH AFRICAN REVENUE SERVICE

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²¹ Section 28 of the TA Act.

²² See Interpretation Note 15 “Exercise of Discretion in Case of Late Objection or Appeal”.

²³ The rules for objections and appeals are formulated under section 103 of the TA Act and published in GN 550 GG 37819 of 11 July 2014.

Annexure – Calculation of taxable income

The following examples provide a step-by-step guide to calculating the taxable income of PBOs by applying the basic exemption rule.

Example 13 – Simple determination of taxable income of PBO and tax payable

Facts:

A PBO conducts religious PBAs. The resident minister does not occupy the manse and the congregation has let it to a third party at market-related rates for the full year.

The following information is reflected in the financial statements for the year of assessment ended 30 June 2017:

Total receipts and accruals	R
Donations and tithes from members	660 000
Bequest	40 000
Interest on investment of surplus funds	20 000
Proceeds from annual fête	32 600
Rental income from letting of manse	<u>268 000</u>
Total receipts and accruals	<u>1 020 600</u>

Expenditure

PBA expenses	324 000
Manse (rates, repairs, garden services)	<u>52 000</u>
Total expenditure	<u>376 000</u>

Result:

Step 1 – Determine receipts and accruals exempt from tax

Income attributable to PBAs – exempt section 10(1)(cN)(i)

Donations and tithes from members	660 000
Bequest	40 000
Interest on investment of surplus funds	<u>20 000</u>
Total receipts and accruals attributable to PBAs	720 000

Trading income of an occasional nature – exempt section 10(1)(cN)(ii)(bb)

Proceeds from annual fête	<u>32 600</u>
Total receipts and accruals exempt from tax	<u>752 600</u>

Step 2 – Identify receipts and accruals from other trading activities

Rental income from letting of manse	<u>268 000</u>
Total receipts and accruals not exempt from tax that may qualify for the basic exemption	<u>268 000</u>

Step 3 – Calculation of basic exemption – section 10(1)(cN)(ii)(dd)

The basic exemption is limited to the greater of –

- (a) 5% of total receipts and accruals of R1 020 600 = R51 030; or
- (b) R200 000

Basic exemption is R200 000

Step 4 – Apply basic exemption to receipts and accruals from trading activities that are not exempt

	R
Total receipts and accruals from a trading activity not exempt from tax (step 2)	268 000
Less: Basic exemption (step 3)	<u>(200 000)</u>
Total receipts and accruals from trading activities subject to tax	<u>68 000</u>

Step 5 – Allocate direct expenditure incurred in respect of taxable trading activities to “exempt” and “taxable” receipts and accruals

Expenditure incurred in the production of receipts and accruals from trading activities must be apportioned between the “exempt” and “taxable” portions using the following formula:

$$\frac{\text{Total receipts and accruals subject to tax}}{\text{Total receipts and accruals from a trading activity}} \times \frac{\text{Direct expenditure}}{1}$$

Calculate expenditure attributable to taxable portion of rental income:

$$\frac{68\,000}{268\,000} \times \frac{52\,000}{1} = \text{R}13\,194$$

Expenditure attributable to “taxable” portion of rental income = R13 194

Step 6 – Determine expenditure attributable to “exempt” portion of rental income

	R
Direct expenditure incurred in the production of rental income	52 000
Less: Expenditure attributable to “taxable” portion of rental income (step 5)	<u>(13 194)</u>
Expenditure attributable to “exempt” portion of rental income and not deductible	<u>38 806</u>

Step 7 – Calculate taxable income

Total receipts and accruals not exempt (step 2)	268 000
Less: Exempt portion (step 3)	<u>(200 000)</u>
Total receipts and accruals subject to tax (step 4)	68 000
Less: Allowable expenditure (step 5)	<u>(13 194)</u>
Taxable income	<u>54 806</u>

Step 8 – Calculate income tax payable

Taxable income R54 806 at 28% (2016/2017)	
Income tax payable	<u>15 346</u>

Example 14 – Advanced determination of taxable income of PBO and tax payable*Facts:*

A non-profit company incorporated under the Companies Act, 2008, conducts a PBA of caring for abandoned children. The PBO sells Christmas cards reconditioned by volunteers, operates a bookshop in a shopping mall and holds a concert as a special fundraising event, to supplement its income. Royalty income was received as a distribution from a trust in accordance with section 25B(2).

The following receipts and expenditure are reflected for the year of assessment ending 30 November 2017:

Total receipts and accruals	R
Donations	165 000
Government subsidy	1 100 000
Grants	550 000
Interest on investments	18 000
Bookshop sales	227 400
Royalties – distribution from trust	132 600
Sale of Christmas cards	4 000
Sale of concert tickets	<u>13 000</u>
Total receipts and accruals	<u>2 210 000</u>
Expenditure	
PBA expenses (direct expenditure)	724 000
Bookshop trading expenses (direct expenditure)	48 000
Accounting fees (general (indirect) expenditure)	<u>16 900</u>
Total expenditure	<u>788 900</u>

Note: No portion of the general (indirect) expenditure has been incurred in the production of the investment income or the royalty income.

*Result:***Step 1 – Determine receipts and accruals exempt from tax**

Income attributable to PBAs – exempt section 10(1)(cN)(i)	R
Donations	165 000
Government subsidy	1 100 000
Grants	550 000
Interest on investments	<u>18 000</u>
Total receipts and accruals attributable to PBAs	1 833 000

Trading income of an occasional nature – exempt section 10(1)(cN)(ii)(bb)

Sale of Christmas cards	4 000
Sale of concert tickets	<u>13 000</u>
Total receipts and accruals exempt from tax	17 000
Total receipts and accruals exempt from income tax	<u>1 850 000</u>

Step 2 – Identify receipts and accruals from other trading activities	R
Bookshop sales	227 400
Royalties	<u>132 600</u>
Total trading receipts and accruals not exempt from income tax that may qualify for the basic exemption	<u>360 000</u>

Step 3 – Calculation of basic exemption [section 10(1)(cN)(ii)(dd)]

The basic exemption is limited to the greater of –

- (a) 5% of total receipts and accruals of R2 210 000 = R110 500; or
 (b) R200 000

Basic exemption is R200 000

Step 4 – Apply basic exemption to receipts and accruals from trading activities not exempt

The allocation is on a *pro rata* basis in relation to the total receipts and accruals from trading activities subject to income tax using the following formula:

$$\frac{\text{Receipts and accruals from a trading activity}}{\text{Total receipts and accruals not exempt from income tax}} \times \frac{\text{Basic exemption}}{1}$$

Application of formula to bookshop income

$$\frac{227\,400}{360\,000} \times \frac{200\,000}{1} = R126\,333$$

Application of formula to royalty income

$$\frac{132\,600}{360\,000} \times \frac{200\,000}{1} = R73\,667$$

Step 5 – Determine receipts and accruals subject to tax (after deduction of basic exemption)

	Bookshop	Royalty	Total
	R	R	R
Receipts and accruals from trade	227 400	132 600	360 000
Less: Basic exemption (<i>pro rata</i>) (step 4)	<u>(126 333)</u>	<u>(73 667)</u>	<u>(200 000)</u>
Total receipts and accruals from trading activities subject to tax	<u>101 067</u>	<u>58 933</u>	<u>160 000</u>

Note: This step is necessary as the basic exemption applies to receipts and accruals not qualifying for exemption, before calculating allowable deductions. A portion of the expenditure incurred must therefore be allocated to that portion of the receipts and accruals which relate to the basic exemption as it does not qualify under section 23(f), since it will be in the production of exempt income.

Step 6 – Allocate direct expenditure incurred in respect of taxable trading activities to “exempt” and “taxable” total receipts and accruals

Expenditure incurred in the production of taxable total receipts and accruals from trading activities must be apportioned between the “exempt” and “taxable” portions using the following formula:

$$\frac{\text{Total receipts and accruals subject to tax}}{\text{Total receipts and accruals from a trading activity}} \times \frac{\text{Direct expenditure}}{1}$$

Application of formula to bookshop income

Calculate (direct) expenditure attributable to taxable portion of bookshop income:

$$\frac{\text{Total receipts and accruals from bookshop subject to tax}}{\text{Total receipts and accruals from bookshop}} \times \frac{\text{Direct expenditure}}{1}$$

$$\frac{101\,067}{227\,400} \times \frac{48\,000}{1} = \text{R}21\,333$$

Direct expenditure attributable to “taxable” portion of bookshop income = R21 333

Step 7 – Determine expenditure attributable to “exempt” portion of bookshop income

	R
Direct expenditure incurred in the production of bookshop income	48 000
Less: Expenditure attributable to “taxable” portion of bookshop income	<u>(21 333)</u>
Expenditure attributable to “exempt” portion of bookshop income	<u>26 667</u>

Step 8 – Calculate taxable portion of receipts and accruals from the bookshop before allowable general expenditure

Total receipts and accruals (step 2)	227 400
Less: Basic exemption (step 4)	<u>(126 333)</u>
Total receipts and accruals subject to tax (step 5)	101 067
Less: Allowable expenditure (step 6)	<u>(21 333)</u>
Taxable receipts and accruals before deduction of general expenditure	<u>79 734</u>

Step 9 – Calculate general (indirect) expenditure

Expenditure incurred which does not specifically relate to a particular source of income but which can be attributed to various sources of receipts and accruals must be apportioned on a *pro-rata* basis using the following formula:

$$\frac{\text{Specific source of receipts and accruals}}{\text{Total receipts and accruals}} \times \frac{\text{General expenditure}}{1}$$

Step 10 – Source of receipts and accruals to which general expenditure is to be apportioned (based on formula in step 9)

	Total receipts
	R
PBAs (Donations + subsidy + grants)	1 815 000
Bookshop	227 400
Sale of Christmas cards	4 000
Sale of concert tickets	<u>13 000</u>
Total receipts and accruals (excluding investment and royalty income)	<u>2 059 400</u>

Application of formula (step 9) to bookshop income

$$\frac{227\,400}{2\,059\,400} \times \frac{16\,900}{1} = R1\,866$$

Note: For purposes of this Note, the formula has only been applied to bookshop income, but the formula must be applied to all other sources of receipts and accruals.

Proportionate general expenditure to be deducted from specific source of receipts and accruals

Specific source of receipts and accruals	Total receipts R	Allocated expenditure R
PBAs (Donations + grants + subsidy)	1 815 000	14 894
Bookshop	227 400	1 866
Sale of Christmas cards	4 000	33
Sale of concert tickets	<u>13 000</u>	<u>107</u>
Total	<u>2 059 400</u>	<u>16 900</u>

Step 11 – Allocation of general (indirect) expenditure between “taxable” and “exempt” portion of bookshop income

$$\frac{\text{Total receipts and accruals from bookshop subject to tax (step 5)}}{\text{Total receipts and accruals from bookshop}} \times \frac{\text{Allocated expenditure}}{1}$$

$$\frac{101\,067}{227\,400} \times \frac{1866}{1} = R829$$

Step 12 – Determine taxable income from the bookshop

Total receipts and accruals from bookshop subject to tax (step 5)	R 101 067
Less: Direct expenditure determined (step 6)	<u>(21 333)</u>
	79 734
Less: General (indirect) expenditure determined (step 11)	<u>(829)</u>
Taxable income from bookshop	<u>78 905</u>

Step 13 – Calculation of total taxable income

Taxable income from the bookshop (step 12)	78 905
Taxable income from trust distribution (Royalties) (step 5)	<u>58 933</u>
Total taxable income	<u>137 838</u>

Step 14 – Calculate income tax payable

Taxable income R137 838 at 28% (2016/2017)	
Income tax payable	<u>38 595</u>