

INTERPRETATION NOTE: NO. 24 (Issue 3)

DATE: 4 February 2014

ACT : INCOME TAX ACT NO. 58 OF 1962
SECTION : SECTION 10(1)(cN)
SUBJECT : INCOME TAX: PUBLIC BENEFIT ORGANISATIONS: TRADING RULES – PARTIAL TAXATION OF TRADING RECEIPTS

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Preamble

In this Note unless the context indicates otherwise –

- “**Minister**” means the Minister of Finance;
- “**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 under section 30(3);
- “**Schedule**” means a Schedule to the Act;
- “**section**” means a section of the Act;
- “**the Act**” means the Income Tax Act No. 58 of 1962; and
- any word or expression bears the meaning ascribed to it in the Act.

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

New legislation was introduced in 2000, which came into operation on 15 July 2001, to provide for the exemption from income tax of the receipts and accruals of PBOs carrying on PBAs. The legislation contained strict provisions which prohibited PBOs from carrying on trading or business activities outside narrowly defined rules in section 30. A PBO that did not comply with these rules lost its exempt status and became a taxable entity. This had harsh consequences for PBOs and the legislation was amended in 2006 to allow for a partial taxation system for PBOs (see Issue 2 of

this Note, available on the SARS website www.sars.gov.za under Legal & Policy / Archive / Interpretation Notes). A PBO may now carry on limited trading or business activities provided its sole or principal object remains the carrying on of approved PBAs. Partial taxation came into operation on 1 April 2006 and applies to a PBO from its first year of assessment commencing on or after that date.

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;

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 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 which occupies 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 approved 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

An undertaking or 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 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 which serves and sells 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

In the strict sense the concept of “substantially the whole” is regarded by SARS as 90% or more. In order to overcome certain practical difficulties SARS will, however, accept a percentage of not less than 85%. This percentage may be motivated by taking into account time or cost. See Binding General Ruling No. 20 dated 10 December 2013 which provides clarity on the interpretation of the expression “substantially the whole” which is available on the SARS website.

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 approved 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

The expression “total receipts and accruals” includes the total sum of all receipts and accruals from any source within or outside South Africa, irrespective of whether on capital or revenue account.

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. In determining whether a PBO has such an unfair advantage each case will be considered on its own merits.

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 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 approved 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 [section 10(1)(cN)(ii)(aa)]

In order to qualify for this exemption –

- 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 approved 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.

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 [section 10(1)(cN)(ii)(bb)]

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

- 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.

6.3 Ministerial approval [section 10(1)(cN)(ii)(cc)]

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

- 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. To date, no such activities have been approved by the Minister.

The submission together with the fully motivated representation must be addressed to:

The Group Executive: Interpretation and Rulings
 Legal and Policy Division
 South African Revenue Service
 Private Bag X923
 PRETORIA
 0001

6.4 Basic exemption [section 10(1)(cN)(ii)(dd)]

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 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.

Example 12 – Basic exemption

Facts:

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

The PBO's total receipts and accruals for the year ended 28 February 2013 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.

7. Practical application of the basic exemption

7.1 Determination of the basic exemption threshold

The total receipts and accruals derived from all trading activities that do not qualify 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 or trading activities and not individually to each such business or trading activity.

In the case of an approved regulating or co-ordinating body of a group of PBOs, 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 which relates 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, which does not specifically relate 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 which is 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 approved PBAs. Such an allocation is necessary in order to exclude from deduction the portion of expenditure incurred in the production of exempt income.

8. Income from a trust of which a PBO 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.¹

To the extent that an amount is not deemed to accrue to a beneficiary it is deemed to accrue to the trust.²

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

¹ Section 25B(1) and (2).

² Section 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 applies the income will be deemed to accrue to the trust donor.

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.

Losses incurred during years of assessment commencing on or after 1 April 2006 when the partial taxation system became applicable may be carried forward to the following 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 No. 33 (Issue 3) “Assessed Losses: Companies: The ‘Trade’ and ‘Income from Trade’ Requirements” dated 4 February 2014. This Note applies to PBOs that are companies and not to PBOs that are registered as trusts.

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 approved 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 or trading activities in the current year of assessment as a result of its income from such trading 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 No. 47 (Issue 3) “Wear-and-Tear or Depreciation Allowance” dated 2 November 2012.

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 No. 19 (Issue 3) “Year of Assessment of Natural Persons and Trusts: Accounts accepted to a date other than the last day of February” dated 9 October 2013.

A PBO that is a non-profit company as defined in section 1 of the Companies Act No. 71 of 2008, as well as an association 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.

12. Rate of tax

A PBO that is liable to tax on receipts and accruals which do not qualify for exemption, will pay tax at a single flat 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.

13. Provisional tax

A PBO is exempt from making provisional tax payments.³ Any liability to income tax on taxable income will become payable on assessment.

14. Capital gains tax (CGT)

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.

Under paragraph 63A of the Eighth Schedule a PBO must disregard any capital gain or capital loss made on the disposal of certain categories of assets. 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 No. 44 (Issue 2) “Public Benefit Organisations: Capital Gains Tax”, dated 4 February 2014.

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 No. 22 (Issue 2) “Exemption: Public Benefit Organisations and Statutory Bodies” dated 9 December 2008.

³ Paragraph (aa) of the exclusions to the definition of a “provisional taxpayer” in paragraph 1 of the Fourth Schedule to the Act.

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

Any books of account, records or other documents, including annual financial statements, relating to any PBO must be retained and carefully preserved for a period of at least four years after the last date of an entry in any book or, if kept in electronic format or any other form, for a period of four years after completion of the transaction, act or operation to which they relate.⁴

16.2 Income tax returns

PBOs must annually submit the prescribed income tax return to enable SARS to assess whether the PBO is operating within the prescribed limits of the relevant approval granted and to determine whether the partial taxation principles have been applied to receipts and accruals derived from a trading activity or business undertaking which does not qualify for exemption.

17. Objection and appeal

A PBO that does not agree with any assessment that has been issued by SARS may lodge an objection against the assessment. If the objection is disallowed or partially disallowed, the PBO has the right to lodge an appeal against the disallowance or partial disallowance.

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 and Policy Division
SOUTH AFRICAN REVENUE SERVICE

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⁴ Section 30(9).

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 2013:

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:

Step1 – 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	<u>720 000</u>

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:

$$\frac{68\,000}{268\,000} \times \frac{52\,000}{1} = \text{R13 194}$$

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% (2012/2013)	
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 2013:

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	<u>1 833 000</u>
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	<u>17 000</u>
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

$$\frac{227\,400}{360\,000} \times \frac{200\,000}{1} = \text{R}126\,333$$

Application of formula to royalty income

$$\frac{132\,600}{360\,000} \times \frac{200\,000}{1} = \text{R}73\,667$$

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

	Bookshop R	Royalty R	Total 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	(21 333)
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)	(126 333)
Total receipts and accruals subject to tax (step 5)	101 067
Less: Allowable expenditure (step 6)	(21 333)
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	13 000	107
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

	R
Total receipts and accruals from bookshop subject to tax (step 5)	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% (2012/2013)	
Income tax payable	<u>38 595</u>