Ref #763280

Submission File

30 April 2020

South African Revenue Service
Private Bag X923
Pretoria
0001

BY E-MAIL: policycomments@sars.gov.za

Dear SARS

COMMENTS ON THE DRAFT INTERPRETATION NOTE ON THE "FUNDING" REQUREMENT FOR SECTION 30B(2)(b)(ix) ASSOCIATIONS AND TRADE UNIONS

1. We herewith take an opportunity to present our comments on behalf of the South African Institute of Chartered Accountants' (SAICA) on the draft Interpretation Note on the "funding" requirement for associations and trade unions in terms of section 30B(2)(b)(ix) of the Income Tax Act, No 58 of 1962 (the Act).

COMMENTS

Non-member funding threshold

2. In BGR 20 SARS notes that it will interpret "substantially the whole" as 90% but will accept 85% as meeting the criteria.

3. In our view the law does not allow SARS to take a position contrary to the promulgated law and thus we consider the BGR position to be unlawful.

4. SAICA supports the 85% threshold but is of the view that it should be included in law to avoid uncertainty and debate, especially should a dispute arise.

5. Submission: Though we support the 85% threshold, we believe that SARS should engage National Treasury to align the legislative position to the SARS practice.

6. We also express concern that this threshold is not disclosed in ITR12EI which has resulted in enforcement being very difficult for the SARS TEU as the financial disclosures do not compel a split between member and non-member funding. Compliance by associations or trade unions with the 85% threshold is thus questionable.

7. SAICA met with the SARS TEU in 2019 and submitted that the ITR12EI should be amended to reflect disclosure of the section 30B (and other exempt entity disclosures) compliance requirements to make oversight by SARS TEU easier. Currently this is a

manual process and only possible for SARS TEU if the financial statements disclose enough information to actually apply the various financial tests.

8. We do not believe that this can be resolved by interpretation and that the lesser compliance model may most probably have to be replaced with a higher administrative compliance but more lenient income model, such as the part exempt model for PBO's.

9. Submission: We believe that SARS and Treasury should engage the associations and unions on changing the exemption model, with greater enforcement of the current regime the alternative to ensure parity of compliance in this sector.

Exemption of capital amounts

10. The Draft IN seems to indicate that the "receipts and accruals" that are exempt in section 10(1)(d)(iv) are only amounts of gross income, though the legislation does not expressly state so.

11. SAICA supports the exclusion of capital amounts from the section 30B funding threshold requirements.

12. Though capital gains are included into "taxable income" by section 26A of the Act, paragraph 63 of the Eighth Schedule disregards any capital gain or capital loss for any person that is exempt under section 10 of the Act.

13. Submission: SARS should confirm the treatment of capital amounts in the Draft IN. It may also be prudent that SARS engage National Treasury to clarify the legislation regarding capital amounts.

Receipts & accruals vs Funding

14. It also remains unclear how "receipts and accruals" are reconciled with "funding" in section 30B.

15. Submission: SARS should clarify what amounts are "receipts and accruals" and not "funding".

Capital amounts and foreign donor funding/aid

16. The treatment of grants or other targeted funding remains unclear.

17. In many instances the funding is targeted on capital projects such as purchasing buildings or capital equipment.

18. However, it remains unclear how SARS will expect such grant funding or aid, especially foreign donor funding, to be treated from a gross income or capital perspective.

19. Will SARS see these as capital receipts and not as "funding" as it is not gross income and exempt? Also will the capital nature be determined by referring to what the amount was donated for, i.e. whether that was capital or revenue.

20. For example, SAICA might receive monies from the International Federation of Accountants (IFAC) to develop and encourage the adoption of IFRS in African countries or to encourage learners to take maths and accounting. Both these activities are supporting SAICA's principle object but would it be exempt funding if not applied for capital purposes.

21. Submission: SARS should clarify how exempt persons should deal with capital grant or donor funding, especially from foreign organisations and where such donations, grants or aid are in relation to activities of the exempt person's principle objective.

Funding and sole or principle object

22. SARS introduces a criterion on page 7 and 8 that "funding" means financial activities in the furtherance of its sole or principle object as set out in its founding document i.e. it must contribute to achieving the person's sole or main object.

23. Therefore, SARS is of the view that any additional products and services income must also be connected to the sole or main purpose.

24. This requirement is not in the law and is in fact a section 30 PBO requirement.

25. Section 30B only has such requirement as to how funds are spent, not why they are received.

26. Should this become the view it means all funding activities from members but not directly related to the "sole or main" purpose seems to create a transgression of the exemption and risks exemption withdrawal.

27. It is therefore not the receipt of monies that must comply but the application thereof and though they may be related they also may not be, for example there may be funding that no expenses were incurred like grant / donor aid or advertising sponsorships which are used to provide products and services.

28. Submission: The use of "sole or principal object" in relation to the funding requirement is incorrect in law and should be deleted. It may be useful for SARS to rather clarify this requirement in relation to the application of funds where it is a legal requirement.

Non related products and services

29. The examples in Example 1 only provide guidance on what SARS believes to be related products and services.

30. For example, are the bargaining council levies from non-union members and commissions to trade unions from member third party services providers like funeral underwriters such non related products and services funding?

31. Submission: We believe SARS should provide examples of what is not related products and services even if it is only relevant to the application of funding and not the receipt of funding.

Other sources of funding – Compelled levies

32. In many industries there are compelled levies payable to organisations, for example, monies payable to bargaining councils by non-members and quasi regulators like water and agri-boards.

33. As these levies are not from voluntary members but compulsory levies, it is unclear how these should be dealt with as this would constitute the majority of funding.

34. Submission: SARS should clarify how organisations that exclusively receive levies imposed from non-members should be addressed.

Other sources of funding – application threshold

35. The Draft IN notes in footnote 21 stipulates that section 30B(2)(b)(iv) introduces a compelled minimum spending threshold, i.e. at least 90% of its funds must be used annually for the sole or principal object.

36. It is submitted that this is not what section 30B(2)(b)(iv) seeks to require but rather compelling the use of expended funds and not all funds to be used substantially the whole for the sole or principal function, thereby ensuring that funds are applied to such sole or primary objective (i.e. spending rule).

37. It would seem that SARS is introducing a compelled minimum distribution rule as applicable to PBO's in terms of section 18A.

38. This interpretation is also highly impractical and will result in may exempt entities not complying as they would be effectively penalised for receiving lump sums (i.e. for hosting large member events) that are to be expended over time or saved for a specific purpose such as buying a building. It may also be argued that such argument is self-defeating as per SARS' own normal grammatical meaning, the invested amounts are itself funding i.e. money immediately available.

39. This means you would always have to include invested amount balances as funding and as part of non-member funding.

40. Submission: We do not agree or support SARS' view on the meaning of section 30B(2)(b)(iv) and submit that its true meaning in context is that it requires that actual expended funds should be 90% towards the entities sole or main objective.

Other sources of funding – change in nature

41. The Draft IN states that ALL passive income i.e. investment income is non-member funding even if it was derived from invested member funds, for example, bank interest or dividends from subsidiaries.

42. We do not believe that at a minimum, member funding in cash investments or bank deposits can be seen as non-member funding. It is submitted that the mere act of banking money cannot turn it into non-member funding and that the fruit of the tree (i.e. interest) should retain its nature for the purposes of member funding.

43. We accept that tracing mixed funds may be problematic but would rather seek tracing than total exclusion.

44. Submission: It is submitted that invested funds, especially cash funds and returns should still be regarded as member funding. A pragmatic approach would be to deem non-member funding as being expended first.

Appropriations from government

45. The Draft IN confirms the narrow scope of "appropriations from government" to be only from the National, Provincial and Local Government.

46. Accordingly, funding from all scheduled entities, agencies and SoE will be excluded and such appropriations will be non-member funding. Amounts from SETA's, Universities, Education Agencies etc. and scheduled entities like SARS or SEDA or foreign government aid or grants will be non-member funding.

47. This is quite problematic as government habitually uses other entities and agencies to do governments work and routes funds through these entities and agencies.

48. Also entities like the SETA's are specifically created to support entities like SAICA and therefore it is problematic that grants from SETA will contribute to non-member funding even if such monies are directed to the sole or main objective.

49. Submission: SAICA accepts that taking a wider interpretation may not be possible. However, unless government stops using entities outside the 3 tiers of government to perform its public duty, it remains very difficult to comply with this requirement. It is submitted that SARS urgently approach National Treasury to have the legislation expanded to other government entities as this would still be in line with the purpose and intention of the Act.

Withdrawal of approval

50. In respect of non-compliance it seems (though unclear) that SARS take the position if the non-compliance is not corrected after notice was given, the exemption is withdrawn from the year of first non-compliance and not from the current year of assessment.

51. This would seem impracticable because if for example the entity failed the funding test 3 years ago, it would never be able to correct it and would at most be able to correct from the current year when the notice was received.

52. It also would mean that if the exemption is withdrawn retrospectively, that following years would be taxable and would have to be reassessed as a company with resubmission of an ITR14.

53. We accept that if the withdrawal is only applicable after notice provided by SARS, compliant taxpayers are at a disadvantage as many taxpayers will now "ride the system" till caught.

54. We believe that the only way to get to an equitable and practical solution is to amend the legislation.

55. Submission: It is proposed that SARS engage National Treasury to amend the legislation so that the sanction for non-compliance is not only withdrawal, especially possible retrospective withdrawal of exemption, but that other sanction such as penalties be introduced. This would ensure a balance between SARS ability to regulate the industry and also sanction historical non-compliance without creating an incentive for non-compliance. However, in the interim we would support an interpretation that withdrawal can only apply after notice of corrective steps and if that the entity does not take steps to correct going forwarding after the notice is received.

Record keeping

56. The Draft IN makes a general statement regarding record keeping and does not give guidance on specific matters.

57. As noted above, the current books of records etc. do not assist the SARS TEU to determine compliance.

58. Submission: It may be prudent to note in the Draft IN that books of account should at a minimum be compiled on the basis of indicating compliance with the funding and spending requirements of section 30B.

Should you wish to clarify any of the above matters please do not hesitate to contact us.

Yours sincerely

Pieter Faber **Dr Sharon Smulders**
Senior Executive: Tax **Project Director: Tax Advocacy**
The South African Institute of Chartered Accountants