THE DONATIONS DI LEMMA

A REVIEW OF THE INCOME TAX EFFECT ON DONATIONS AND CORPORATE SPONSORSHIPS?

Russell Grant Smith
Student Number: SMTRUS008

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Lecturer: Trevor Emslie SC
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1. INTRODUCTION

The payment of sums to charities, sporting associations and similar organisations falls within a contentious area when viewed by our courts, and can take the form of donations, sponsorships or contributions. The nature and purpose of these disbursements will determine whether they qualify for deduction in the determination of liability for income tax under the Income Tax Act 58 of 1962\(^1\).

The pitfall of making contributions to these associations is that they can be seen as having no trade purpose or not being in the production of income, and hence not deductible under the general deductions provisions of s11(a) read with s23(g).

Donations made to certain public benefit organisations qualify as tax-deductible expenses under s18A, however for the purposes of this paper we will look only at contributions to associations that do not qualify as public benefit organisations. In order for these payments to be tax-deductible they need to satisfy the criteria under the general deductions formulae. It is therefore in the donor’s interest to ensure that the contribution satisfies these criteria in order to qualify for deduction.

The nature of the payment and the benefit obtained from it, will directly determine whether the expense is tax-deductible for the contributor. Tax deductibility can often play a deciding factor on the part of the contributor as to whether to make a contribution to such an organisation and the extent of this contribution.

This paper will examine the grey area of interpretation that relates to these expenses, their treatment and their qualifying nature as deductions from income, with respect to available case law and a discussion of the Income Tax Act\(^2\). Specifically we will analyse the judgement of the Appellate Division case of CIR vs. Pick ‘n Pay Wholesalers (Pty) Ltd\(^3\), in which the latter failed to justify that a charitable contribution indeed had a dominant business purpose.

2. THE CONCEPTS

To begin, it is necessary to understand the essential concepts that will be discussed in order that we do not hastily prejudice our conclusions by the use of words, which may be taken out of context.

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1 Hereinafter referred to as the Income Tax Act.
2 Note: The issue of Donations Tax will not be discussed in this paper.
3 COMMISSIONER FOR INLAND REVENUE v PICK ‘N PAY WHOLESALERS (PTY) LTD (1987) 49 SATC 132
Particularly where the term donation is used in its broader sense to mean contributions made to charitable institutions. Some of the terms we will look at are not defined in the Income Tax Act and in these instances it is necessary to look to their literal meaning as a guide.

Donations are not defined in section 1 (interpretation) of the Income Tax Act, however section 55(1)\(^4\) dealing with donations tax, defines a donation as ‘any gratuitous disposal of property including any gratuitous waiver or renunciation of a right’. This definition remains vague as it does not explain or define ‘gratuitous’, which is an essential element in the act of a donation.

As an example, when Vladimir Kotov gave his first prize medal (R60,000) for winning the 2004 Comrades Marathon to the next South African across the finish line (Willie Mtolo)\(^5\), did he donate this as a gift? From the definition it would appear so. Moreover if he is a professional sportsman, and no doubt he is, should he still be taxed on the proceeds thereof? While this introduces an interesting debate, such a discussion is beyond this paper.

The Oxford definition of a donation on the other hand is “The action or contract by which a person transfers the ownership of a thing from himself to another, as a free gift.”\(^6\) It goes on to say that the thing given is “Something, the possession of which is transferred to another without the expectation or receipt of an equivalent; a donation, present.” The thing in such cases is generally represented by a gift, contribution, free service or sum of money.

It would appear that a sum of money given to an institution where there is an obligation on the institution to deliver or provide a degree of advertising exposure or publicity does not qualify as a donation. A donation implies that there is no reciprocal obligation on the part of the receiver.

The thing received indeed represents a benefit to the receiving organisation to the extent that it helps to fund their operations or achieve their organisational objectives. These organisations are generally, but not necessarily, non-profit associations and the receipts represent income in their hands. While we will not be examining the income side of such transactions, it is often necessary to understand the operational value of the receipt in the receiver’s hands in order to interpret the intention of the contributor in making such disbursements.

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\(^4\) s55(1) of The Income Tax Act No. 58 of 1962  
\(^5\) The Mercury Newspaper; I am a South African; June 17 2004; page 1  
The payer of such amounts generally seeks to obtain one or a variety of benefits for such payments. These can range from purely trade motivated objectives such as publicity and advertising to more philanthropic motives like supporting charitable causes.

There is a catch 22 in that “while tax-exempt organisations mainly chase corporate sponsorship dollars to raise operating revenue, taxable corporate donors support tax-exempt organisations in an effort to appeal to the heart and, as a result, to the pocketbook of the public consumer.” \(^7\) Corporate sponsors are being less and less altruistic as they select charities that will best meet their requirements for publicity and exposure targeted towards their particular customer market. On the other hand charitable organisations need to attract these corporate sponsorships and hence aim their activities towards particular market segments, which are more or less predisposed towards the targeted donor’s market.

This brings us to the definition of a sponsor which taken from The American Heritage Dictionary is defined as “a person or organisation that pays for or contributes to the costs of a sporting or artistic event or a radio or television programme in return for advertising; or a person who pledges an amount of money to a charity after another person has participated in a fund-raising event.” And further for sponsorship as “One that finances a project or an event carried out by another person or group, especially a business enterprise.” \(^8\)

Hence a sponsorship cannot equate to a donation in terms of their definitions as one implies a reciprocal action while the other leaves behind no corresponding obligation. Sponsorships are very valuable means of advertising for companies as they create a valuable link between the company and its products on one side and the charity or institution and its values on the other. In effect the benefit of being associated with such charitable institutions can be of far greater ‘marketing’ value than the sponsor could have achieved through direct advertising. The publicity it gains is less subtle but achieves a far greater impact on our social conscience.

American tax law has taken steps to prevent companies and charities from exploiting this dilemma. The American Inland Revenue Service enacted the Unrelated Business Income Tax\(^9\), which seeks to tax tax-exempt organisations that receive sponsorships under a quid pro quo type system (where particular performance is obligatory in the terms of the contribution). In this way the benefit of chasing corporate sponsorships by charities is effectively diluted\(^10\).

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\(^7\) Tax Lawyer: The 2000 proposed regulations on corporate sponsorship payments; Winter 2001 at page 357
\(^8\) The American Heritage Dictionary of the English Language, Fourth Edition
\(^9\) Ohio Northern University Law Review: Section 513(I) of the internal revenue code; 1999 Vol. 25
\(^10\) Loyola of Los Angeles Law Review: How the IRS blew the corporate sponsorship game; June 1994
Since publicity and advertising will perform an important role in any sponsorship arrangement and indeed many of our understood ‘donation’ contributions we need to understand what it implies.

According to Wordnet at the Princeton University, the definition of advertising is “a public promotion of some product or service; the business of drawing public attention to goods and services (publicising).”\(^{11}\) This publicity as we have discussed earlier forms a crucial element of many contribution arrangements as it will create business advantage to the contributor, or better said “rational corporate directors will authorize charitable acts to the extent they increase shareholder wealth.”\(^{12}\)

3. \textbf{DEDUCTIBILITY UNDER THE ACT}

Donations and sponsorships can be deducted as expenses under the general deductions formulae s11(a) of the Income Tax Act, provided that they satisfy the following criteria, namely that the expense is:

- Actually incurred;
- In the production of income;
- For a trade purpose; and
- Not capital in nature.

When interpreting whether the requirements of s11(a) have been met, it is also necessary to look at the exclusion clause of s23(g), which does not allow certain expenses to be deducted from income, “to the extent to which such moneys are not laid out or expended for the purposes of trade”\(^{13}\). Where an amount is expended for a purpose, which is not wholly for the purposes of trade, then to the extent that it is not for trade purposes, it will not be deductible. This could occur in cases where there is a dual purpose, in which case it is necessary to apportion the expenditure incurred between the two purposes and only deduct that portion of the expense that is incurred for the purposes of trade.

\(^{11}\) WordNet 2.0; Princeton University; 2003
\(^{12}\) Tax Lawyer: The 2000 proposed regulations on corporate sponsorship payments; Winter 2001 at page 362
\(^{13}\) s23(g) of The Income Tax Act No. 58 of 1962
3.1. Actually Incurred

All the criteria of s11(a) need to be satisfied before expenditure incurred for donations and sponsorships can be deducted from the liability for income tax. While there is seldom doubt that these contributions are actually incurred, this is always a question of fact and is dependent on the particular circumstances of each case.

In the cases of Nasionale Pers vs. KBI\(^{14}\) and Concentra (Pty) Ltd vs. CIR\(^{15}\) it was confirmed that actually incurred does not mean actually paid. Rather it means that there is an unconditional legal liability to pay an amount. Hence, entering into a contractual sponsorship agreement or similar contractual contribution for publicity would create this unconditional liability once payment falls due.

Furthermore, Watermeyer AJP in PE Electric Tramway Co Ltd vs. CIR\(^{16}\) said that “actually incurred does not mean necessarily incurred”\(^{17}\) in terms of the prudence of such expenditure. Whether expenditure is incurred efficiently in the activities of business operations is immaterial, so long as it was actually incurred. This is also important since donations and sponsorships can often be perceived as unnecessary expenditure for a business. Under this criterion it is sufficient that the expenditure is actually incurred.

3.2. In the Production of Income

The s11(a) requirement for expenditure to be incurred in the production of income is critical for our review of donation and sponsorship payments. This requirement together with the trade purpose discussed later, effectively precludes taxpayers from making payments as philanthropic donations, gifts or otherwise. Except for the allowance granted under s18A for donations to qualifying institutions, these would be disallowed as deductions from income. Only if the purpose for which the payment is made, is to produce income for the taxpayer, then it may be deducted under s11(a).

In PE Electric Tramway Co Ltd vs. CIR, Watermeyer AJP noted “businesses are conducted by different persons in different ways. The purpose of the act entailing expenditure must be looked to. If it is performed for the purpose of earning income then the expenditure attendant upon it is deductible.”\(^{18}\)

\(^{14}\) NASIONALE PERS v KOMMISSARIS VAN BINNELANDSE INKOMSTE (1986) 48 SATC 55
\(^{15}\) CONCENTRA (PTY) LTD v COMMISSIONER FOR INLAND REVENUE (1942) 12 SATC 95
\(^{16}\) PORT ELIZABETH ELECTRIC TRAMWAY CO. V COMMISSIONER FOR INLAND REVENUE (1936) CPD 241, 8 SATC 13
\(^{17}\) Ibid at page 15
\(^{18}\) Ibid at page 16
In his judgement, Watermeyer AJP lays down two tests that can be used to determine whether an expense is incurred in the production of income, these being:

a) Whether the act, to which the expenditure is attached, is performed in the production of income, and

b) Whether the expenditure is linked closely enough to the act so as to appear part of the cost of performing it.

In the case of *Joffe & Co vs. CIR*\(^{19}\), Watermeyer CJ interprets this requirement by asking the question as to whether “the expense was a necessary concomitant of the taxpayer’s trading operations”\(^{20}\). By using this test he ascertained that the expenditure in question, damages paid due to negligence, were not incurred in the production of income.

With respect this approach did not take sufficient heed of the connection between the act and the expense incurred. If one accepts the notion that negligent acts are an inevitable concomitant of business operations (hence our tendency to insure against them), and that such acts could give rise to claims against the business for negligence, then it follows that the resultant cost of these claims is a necessary concomitant of the same business operations. The important test it would appear is whether the act which gives rise to the expense is in fact a necessary concomitant of the taxpayer’s trading operations.

*In the production of income* does not mean that the income must necessarily be earned. In the case of *Sub Nigel Ltd vs. CIR*\(^{21}\) the appellant, a mining company, paid premiums on insurance policies that would compensate the insured for loss of profits and cover the cost of standing charges in the event of a fire disrupting or curtailing business operations. The Commissioner argued that in the years under review no income was generated as a result of the expenditure incurred on these premiums and therefore such expenditure could not be seen to be in the production of income.

Centlivres JA found that “there is nothing in any of the judgments to support the proposition that unless a profit is shown actually to result from expenditure, such expenditure cannot be said to have been incurred in the production of income or for the purposes of trade.”\(^{22}\) He goes on further to say that “the Court is not concerned whether a particular item of expenditure produced any part of the income: what it is concerned with is whether that item of expenditure was incurred for the purpose of

\(^{19}\) *JOFFE & CO (PTY) LTD v COMMISSIONER FOR INLAND REVENUE* 13 SATC 354

\(^{20}\) Ibid at page 355

\(^{21}\) *SUB-NIGEL LTD v COMMISSIONER FOR INLAND REVENUE* 15 SATC 381

\(^{22}\) Ibid at page 384
earning income.”\textsuperscript{23} In this case the event for which the taxpayer was insuring (fire), would have produced income on the event occurring. This was sufficiently a purpose of earning income and restoring profits for the courts.

The approach of \textit{PE Electric Tramways} was further confirmed in \textit{CIR vs. Nemojim}\textsuperscript{24} where Corbett JA states “In deciding how the expenditure should properly be regarded, the Court clearly has to assess the closeness of the connection between the expenditure and the income-earning operations, having regard both to the purpose of the expenditure and to what it actually affects.”\textsuperscript{25}

Probably as notable in this case was the notion of a dual purpose on the part of the taxpayer, which in this instance was to produce income and exempt income as defined. In his \textit{obiter dictum} Corbett JA made use of an apportionment formula to be used to determine the portion of expenditure incurred in the production of income and exempt income, hence allowing as a deduction only that expenditure incurred in the production of income as defined. This was a landmark case in that it opened the way for use of apportionment in cases where the taxpayer had a dual purpose.

In the case of \textit{KIR vs. van der Walt}\textsuperscript{26}, Eloff ADJ RP found that where the taxpayer could show that he/she had “\textit{bone fide} incurred expenditure for the more efficient performance of his/her duties of employment”\textsuperscript{27}, this was sufficient to establish the necessary connection between the earnings of the taxpayer and the expenditure incurred. The expenditure of the taxpayer could then be said to have been incurred in the production of income.

Expenditure incurred on donations and sponsorships must be incurred in the production of income to be deductible, or put another way, there must be a business objective behind the expenditure that aims to generate revenue and therefore income to the business.

In many instances this is substantiated through the benefits of publicity and advertising that is generated through these sponsorships and donations. The link between the income generated from such publicity and the expenditure incurred is very difficult to establish as H.G. Galbraith said in \textit{ITC 696}\textsuperscript{28}: “I consider that it can fairly be stated that it is normally impossible to connect any particular

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{23} Ibid at page 394
\item \textsuperscript{24} COMMISSIONER FOR INLAND REVENUE v NEMOJIM (PTY) LTD 45 SATC 241
\item \textsuperscript{25} Ibid at page 256
\item \textsuperscript{26} KOMMISSARIJS VAN BINNELANDSE INKOMSTE v VAN DER WALT 48 SATC 104
\item \textsuperscript{27} Ibid at page 105
\item \textsuperscript{28} INCOME TAX CASE NO 696 (1950) 17 SATC 86
\end{itemize}
\end{footnotesize}
sales with any particular advertising, though many companies go to considerable lengths in an endeavours to ascertain which media of advertisements produce the best results”.  

3.3. Not Capital in Nature

Expenditure may not be deducted under s11(a) if it is capital in nature. It would appear that for our purposes the nature of donations, advertising and sponsorship expenses should not be capital, however this has not always been the case as will be shown. First, it is necessary to point out the tests which are used by the courts to determine the capital / revenue nature of such costs.

In CIR vs. Guardian Assurance Holdings30 it was held that an expense is either capital or revenue (not both), and that the expense could be apportioned between capital and revenue where appropriate.

The most important test for the capital / revenue distinction was established in the New State Areas Ltd vs. CIR31 in which Watermeyer CJ distinguished revenue expenditure as being part of the cost of the income earning operations of the taxpayer. On the other hand capital expenditure was part of the cost of establishing or enhancing or adding to the taxpayer’s income earning structure or plant and machinery.

Innes CJ provided a further test in George Forest Timeber vs. CIR32 in that money spent in creating or acquiring an income producing concern or source of future profit was capital, while money spent on working that source was revenue.

Finally Ogilvie Thompson CJ in the case of Palabora Mining Co Ltd vs. SIR distinguished capital expenditure as that which has an enduring benefit as opposed to revenue expenditure, which would not.

While advertising and sponsorship expenses would intuitively appear to be revenue in nature, there are nevertheless instances where they can be seen as capital and hence it is necessary to identify what characteristics define these. This was confirmed in ITC 21733 & ITC 46934, where in the latter case, the appellant built a miniature wooden house as a display for advertising purposes. The court

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29 Ibid at page 92
30 SIR v GUARDIAN ASSURANCE HOLDINGS (SA) LTD (1976) 38 SATC 111
31 NEW STATE AREAS LTD v CIR (1946) 14 SATC 155
32 CIR v GEORGE FOREST TIMBER CO LTD (1924) 1 SATC 20
33 INCOME TAX CASE NO 217 (4 SATC 137)
34 INCOME TAX CASE NO 469 (1940) 11 SATC 261
found that the structure was permanent in nature and hence the expenditure thereon though undoubtedly incurred for advertising purposes, was capital and therefore not deductible.

Both of the above cases involved the construction of a means to display the business’s products. Hence there was a degree of permanence to the structure that was created and this was what persuaded the courts to find in favour of the capital nature thereof. They provided the taxpayer with an improvement to its income earning structure, which would assist the business in producing profits through the display of its materials for a future period and therefore represented an enduring benefit to the companies.

There is a rather tenuous nature to the longevity of such enduring benefit. The same could be said for a payment for advertising in lump sum and upfront, where the benefit thereof is to be received over an extended period, say five years. In such case there is an enduring benefit that will be received from the payment and this should result in a source of future profits through the media of advertising over this period. It can be argued that it has equally added to or enhanced the company’s income earning structure, since it will provide a targeted exposure to its products for an extended period.

The above argument supports the payment of such long contractual obligations in piecemeal fashion over the period of the contract and hence matching the expenditure with the service delivered (advertising). This would certainly purport to present such expenditures as revenue rather than capital.

### 3.4. Trade Purpose

The final requirement that we will examine is the trade requirement that is relevant for deduction of expenditure under s11(a), read with s23(g). In terms of these two sections expenditure is only deductible to the extent to which it is expended for the purposes of trade. This again brings in the notion of dual purpose, as it makes allowance for instances of expenditure where there is more than one purpose, one which is trade and one which is not. It may be necessary to apportion an expense between these two purposes and thereby only deduct that portion of the expenditure incurred for a trade purpose.

This distinction will be critical for our purposes as there can often be a dual motive for payments made in lieu of advertising or sponsorships to institutions and organisations where the taxpayer has an altruistic motive as well as a business objective of obtaining publicity from such payments. We will
examine some of the cases that have helped to shape our understanding of the application of this criterion.

In *ITC 734*\(^{35}\) the courts recognised the dual-purpose nature of expenditure, one of which had a non-trade purpose. The expenditure in this case was not “wholly incurred for the purposes of trade” and hence not deductible. S23(g) has since been amended to exclude only expenditure “to the extent to which it is not incurred for the purposes of trade”.

Two famous UK examples applying the principle of trade purpose are *Strong vs. Woodfield*\(^{36}\) and *Usher’s Wiltshire Brewery vs. Bruce*\(^{37}\). In both cases a brewery sought to deduct costs incurred in keeping an Inn that was an incidental part of its trading business. The Lord Chancellor in the latter case disallowed the deduction stating, “It does not follow that if a loss is in any sense connected with the trade, it must always be allowed as a deduction”\(^{38}\). However in the former case the court found in favour of the appellant on five different types of costs, saying that they were “all items of expenditure essential to the earning of the profits on which Income Tax is payable”. The treatment and application of the equivalent section is subject to diverse results, which are essentially dependent on the individual circumstances of each case.

In applying the section to the case of *SIR vs. Ineson*\(^{39}\), Judge Wessels JA felt it necessary to determine the purpose for which the expenditure was incurred, this being derived by looking at the facts in the particular case. The conclusion reached on these facts was such that the purpose of incurring the expenditure was solely to carry on the operations of the taxpayer’s trade.

In *De Beers Holdings (Pty) Ltd vs. CIR*\(^{40}\), Corbett JA found that the lack of an intention to make a profit resulted in there being no trade objective for the purposes of s23(g). He acknowledges instances where a trader may sell items at a loss for valid commercial reasons, but in such cases it would call for an explanation from the taxpayer to justify the transaction.

With respect this analysis of the trade purpose does not follow from the definition of a trade, which is to derive income as opposed to profit. Profit is the result of income less expenses. Where a business fails to make a profit in one year because its expenses exceed income, this does not suddenly mean

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\(^{35}\) *INCOME TAX CASE NO 734 (1951) 18 SATC 202*  
\(^{36}\) *STRONG AND COMPANY OF ROMSEY, LIMITED v. WOODFIELD* (1906) AC 448  
\(^{37}\) *USHER’S WILTSHIRE BREWERY, LIMITED v. BRUCE* (1915) AC 433  
\(^{38}\) Ibid at page 219  
\(^{39}\) *SECRETARY FOR INLAND REVENUE v INESON* (1980) 42 SATC 125  
\(^{40}\) *DE BEERS HOLDINGS (PTY) LTD v COMMISSIONER FOR INLAND REVENUE* (1986) 47 SATC 229
that the business has no trade purpose or is not trading. By earning income it expects to earn a profit, the existence and extent of this profit is a measure of its success at its trade.

It is difficult to imagine instances where an expense is incurred in the production of income, but not for the purposes of trade or vice versa. It is submitted that these cases necessarily focus on an expense not being relevant to the taxpayer's normal trade and are therefore superfluous expenditure, or that the actions of the taxpayer do not fall within the broader definition of a trade. Several cases have dealt with the application of s23(g), and these have become important to our understanding of trade purpose.

One of the most important cases dealing with the application of s23(g) is that of Solaglass Finance Company (Pty) Ltd vs. CIR\(^{41}\). The appellant was a subsidiary of a group of companies and sought to deduct losses on loans and debts receivable that it had incurred in the course of operations undertaken as a 'money lender' to other subsidiaries within the group.

The losses incurred were found to be revenue in nature, the company operating in the capacity as a money-lender, and in the production of income. The critical and indeed contentious issue arising, was whether the losses were incurred wholly and exclusively for the purposes of trade (as the section then read).

It was clear on the facts that the appellant was trading with the purpose of making profit through providing loans, be it to group companies or other. However what was in dispute and gave rise to separate judgements was whether the appellant had a dual purpose in addition to that mentioned above. Botha, JA (Nicholas, AJA and Nienaber, AJA concurring in the deciding judgement) found that there was a second purpose in making the loans, being to further the interests of the group subsidiaries and thereby the group.

The appellant was created to serve the purpose of 'financier' for the group, this becoming the trading activity of the company. He also noted that the appellant's activities were by virtue of its creation and subsequently, dictated by the policies of the group. These group policies aimed to further the interests of all subsidiaries and the group itself. Botha found that "the link between the appellant's activities and the furthering of the Group's interests was sufficiently close, on the evidence, to cause the latter to fall within the ambit of the word 'purposes' as used in s23(g)"\(^{42}\).

\(^{41}\) SOLAGLASS FINANCE COMPANY (PTY) LTD v COMMISSIONER FOR INLAND REVENUE (1990) 53 SATC 1
\(^{42}\) Ibid at page 29
In the dissenting judgement, Friedman AJA (Grosskopf JA concurring) noted: “it is by no means uncommon, in a large group of companies, for the business of the group to be rationalised in such a way that the activities of each subsidiary are structured with the interests of the group in mind.”\textsuperscript{43} He did not find that the advantage of the loans being provided to the group necessarily comprised a business purpose that was distinct from that of main business of the company.

What is most important in this regard is that the court decided, by way of 3-2, that there was indeed a dual purpose. The method of identifying when such a dual purpose exists is crucial. Botha noted that it is not possible to identify a universal test for determining this, rather its must be established on the facts in each case. I suggest two fundamental points brought him to this conclusion.

Firstly, the financial director as representative for the appellant, when asked what were the aims of the company answered: “The principal objective was by means of consolidating third party debt to secure the most advantageous terms and conditions for borrowings whilst at the same time organizing and ensuring the availability of finance for the group’s subsidiaries. But within the structure of those motives the company was designed to secure profit for itself.”\textsuperscript{44} Immediately there is credence given to the existence of a dual motive:

1) Providing finance for the group at beneficial rates and terms, and
2) Generating profit through trading activities.

Secondly Botha, when arguing against similar hypothetical examples given by the appellant, notes: “The vital points of distinction lie in the nature of the relationship between the bookseller and his customers or the bank and its customers, on the one hand, and the appellant and the Group, on the other.”\textsuperscript{45} While the examples cited were similar in nature as to having main and ancillary objectives, they both exhibited independent relationships between business and customer. I submit that the relationship between the appellant and its customers (other subsidiaries within the group) was sufficient to present Friedman’s secondary result (the benefit of finance provided to the group) as a ‘purpose’ in itself.

\textsuperscript{43} Ibid at page 20
\textsuperscript{44} Ibid at page 26
\textsuperscript{45} Ibid at page 28
4. THE ONUS OF PROOF

Finally it is relevant to mention s82\(^46\) of the Act, which rests the burden of proof on the taxpayer to show that an amount is:

- Exempt from or not liable to tax;
- Subject to a deduction, abatement or set-off; or
- To be disregarded or excluded in terms of the Eighth Schedule.

This onus is important as the majority of cases involve situations that are not clear in terms of their nature and characteristics. Where this ambiguity leads to a dispute over liability for tax and the Commissioner contends that this uncertainty be interpreted in favour of the fiscus, the courts will oblige until the taxpayer has proven sufficiently that this interpretation is incorrect and has through evidence and testimony demonstrated reasons therefore.

It is not sufficient for the taxpayer to simply prove that the Commissioner has erred in his interpretation of the events giving rise to the dispute. He/she must also prove via the facts that his/her interpretation is the correct one. In *CIR vs. Crane*\(^47\); *Professional Suites Ltd vs. COT*\(^48\); *Erf 3183/1 Ladysmith & Another vs. CIR*\(^49\); and *Ovenstone vs. SIR*\(^50\) the taxpayer failed on each occasion to discharge this burden, and the court was obliged to find in favour of the Commissioner.

In the present circumstances, with respect to the interpretation of donations and sponsorships as publicity and advertising expenses this becomes a critical factor. We will see in the cases to follow that the commissioner has sought to question deductions for donations and sponsorship under the guise of publicity and advertising. In each case it is up to the taxpayer to show that such consideration has been paid for the purpose of providing a benefit in the form of advertising and that this was done for the purposes of its trade. Unfortunately some of these taxpayers were not successful and we hope to understand why they failed in these instances.

\(^{46}\) s82 of The Income Tax Act No. 58 of 1962
\(^{47}\) SECRETARY FOR INLAND REVENUE v CRANE (1977) 39 SATC 191
\(^{48}\) PROFESSIONAL SUITES LTD v COMMISSIONER OF TAXES 24 SATC 573
\(^{49}\) ERF 3183/1 LADYSMITH AND ANOTHER v COMMISSIONER FOR INLAND REVENUE (1996) 58 SATC 229
\(^{50}\) OVENSTONE v SECRETARY FOR INLAND REVENUE (1980) 42 SATC 55
5. RELEVANT CASES

The following cases are relevant to our analysis of donations and considerations made by a taxpayer for business purposes. In each case the facts will explain how the consideration is linked to a genuinely sound business objective or trading obligation. While the first three are Special Court decisions, the final case was dealt with in the Appellate Division and will be examined in detail.

5.1. ITC 696

The appellant was a dealer in agricultural products and sought to deduct inter alia, the cost of prizes (footballs) and engraved trophies awarded at a local football club. These prizes and trophies donated by the taxpayer bore words, which connected them to the appellant's products. The President of the tax court, Newton Thompson, J found that with respect to the footballs res ipsa loquitur, the object and effect of the expenditure were sufficiently linked to advertising of the companies products: “The object is advertisement…. I am satisfied that this expenditure is for advertisement purposes, that it has that effect; that it assists in selling the articles in which appellant company deals...”

With respect to the trophies, by majority decision and with the President dissenting, these were also found to be expenses incurred in the production of income and not of a capital nature. The appellant’s ipse dixit was relied upon as to the intention of the purchase of the trophies, the sole reason being for advertisement of the company’s products.

The court found that the prizes and trophies were donated with a business purpose, being to advertise and promote the taxpayer’s products and were therefore deductible.

5.2. ITC 1706

The appellant company was a manufacturing subsidiary of a USA based firm and traded with the USA, Europe and Australia. It was a signatory to and further compelled by its shareholder company to comply with the regulations of the Sullivan Code. This policy required the appellant to take steps to improve the quality of life of its employees outside of work and to adhere to the requirements of the Comprehensive Anti-Apartheid Act (USA 1986).

51 INCOME TAX CASE NO 696 (1950) 17 SATC 86 (C)
52 Ibid at page 87
53 INCOME TAX CASE NO 1706 63 SATC 334
The appellant made annual donations to various charities, social and community causes in order to comply with the requirements of the Sullivan Code. These donations were sought as a deduction from its liability for income tax and were disallowed by the Commissioner in terms of s23(g), being amounts expended not wholly and exclusively for the purposes of trade.

The appellant and its shareholder were assessed annually in terms of their adherence to the code and it argued that “a low rating could cause adverse publicity and a potential loss of business, not only for the United States parent company, but also for the South African arm of the business, through the loss of orders from customers sympathetic to the aims of the principles.”

The court accepted that the appellant was compelled to incur the expenditure, but found that this obligation was imposed by the holding company’s requirements on its subsidiary. The appellant, as a subsidiary, was obliged to comply with these requirements. The question was then asked whether this compulsion to incur the expenditure by the appellant was in fact expenditure wholly and exclusively laid out for the purposes of its (the holding company’s) trade, and not the appellant’s trade. It appeared that “The purpose or, at least, a substantial purpose in this case was to protect the trade of B (the holding company) and its subsidiaries in countries that were opposed to apartheid.”

The appeal was upheld and the expenditure disallowed as a deduction in terms of s23(g). The court concluded that the objective or motive under which the donations were made did not constitute one that the appellant need perform in order to carry on its trade. The distinction being the obligation imposed on the appellant by its holding company, which the court felt did not (in isolation) constitute a necessary business objective for the appellant.

5.3. ITC 1717

The appellant was a wholly owned subsidiary of A who was listed and incorporated in the USA. Co A was a signatory and member to the Sullivan Code, and was subject to compliance with particular regulations including the Comprehensive Anti-Apartheid Act (USA 1986). As part of its compliance, its South African subsidiary (the appellant) was required to maintain a ‘one rating’ in terms of its compliance practices. Failure to obtain this rating would result in the holding company divesting in its

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54 Ibid at page 336
55 My addition: (the holding company)
56 Ibid at page 339
57 INCOME TAX CASE NO 1717 64 SATC 32
interest in South Africa, and the appellant losing all connections and support from the American group companies.

The appellant sought to deduct from its liability for income tax amounts laid out for social responsibility expenditure. These were initially disallowed by the Commissioner as not being in the production of income, but later were further argued to be of a capital nature (to protect its income earning structure and connection to its American group) and not wholly and exclusively for the purposes of trade.

The court found that the expenditure was incurred to enable the appellant to continue trading and was therefore sufficiently closely linked to the business operations to be in the production of income. However it agreed with the Commissioner’s contention that the expenditure was incurred to protect the income earning structure of the business (failure to incur such costs would have resulted in the business structure and access to product and technology being impaired), and hence was capital in nature.

Further the court found that the obligation imposed by the holding company on the appellant to incur the expenditure and comply with the regulations of the Sullivan code, appeared to make the holding company the beneficiary of such expenditure. The appellant did not prove otherwise, and as such it could not be said that the expenditure was incurred wholly and exclusively for the benefit of the appellant’s trade.

The court found in favour of the Commissioner on two counts. With respect the finding as to the capital nature of the payments appears incorrect, since the expenditure neither establishes, enhances nor adds to the income earning structure of the taxpayer (New State Areas Ltd). It merely protects and services the obligation to its holding company, much like an insurance contract would protect against loss of profits on the happening of an insured event.

The finding as to the trade purpose and prohibition under s23(g) reflects that of ITC 1706 and it would appear that the reasoning is almost identical. Whether the taxpayer could have proven that the objective of the expenditure was indeed for its own trade purpose seems unlikely given that it could not convince the court that, but for the obligation imposed by the holding company to conform to the rules of Sullivan Code, it would still have made such contributions. Hence the trade purpose was not its own, but rather its holding company’s.
5.4. Pick ’n Pay Wholesalers (Pty) Ltd vs. CIR

Perhaps the most important case dealing with donations and considerations paid for advertising and publicity is that of Pick ’n Pay Wholesalers (Pty) Ltd. Interestingly this case was awarded in favour of the taxpayer twice in the Special Court (remitted back to the Special Court after new arguments raised in Provincial Court) before being heard in the appellate division. Here, the case was awarded in favour of the Commissioner by way of a split decision. Two judges ruled in favour of the taxpayer, and three in favour of the Commissioner.

The area of disagreement over which the decision hinged concerned the application of s23(g) and the conclusions drawn as to the purpose and objective of the donation. We will have a look at the facts of the case and then understand how the judges came to their respective decisions.

The taxpayer, a major national retailer, donated a sum of R500,000 to the Urban Foundation, a charity set up to improve the lives of urban dwellers in RSA. The amount was donated on the condition that Pick ’n Pay would receive widespread publicity in the form of a public announcement and various press coverage. It was further to be paid in R100,000 instalments over five years and was represented as an advertising expense by the taxpayer. The Commissioner disallowed the deduction in both the 1978 and 1979 years on the basis that the amounts were:

- Not incurred in the production of income;
- Capital in nature; and
- Not laid out wholly or exclusively for the purposes of trade.

The taxpayer showed that indirect marketing was the strongest form of publicity it could achieve and Mr Ackerman (Chairman) and Mr Hurst (Financial Director), testified on behalf of the taxpayer, that the purpose of the donation as far as Pick ’n Pay was concerned, was to achieve publicity and promote Pick ’n Pay’s business. This was achieved and the result of the announcement realised an increase in sales in all of the taxpayer’s stores. The Commissioner did not dispute these facts.

The parties did however dispute the nature of the contribution and whether it in fact represented a donation in terms of the definition. As we have noted a donation represents a gift given without the expectation of a reciprocal benefit. If there is an expressed reciprocal obligation to perform an act or give a service, then the contribution cannot be said to be wholly in kind. This was confirmed by Trollip

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58 COMMISSIONER FOR INLAND REVENUE v PICK ’N PAY WHOLESALERS (PTY) LTD (1987) 49 SATC 132
59 Ibid at page 133
JA in *Ovenstone v Secretary for Inland Revenue*\(^{60}\) in which he says “In a donation the donor disposes of the property gratuitously out of liberality or generosity, the donee being thereby enriched and the donor correspondingly being impoverished, so much that, if the donee gives any consideration at all therefore, it is not a donation.\(^{61}\)”

In this case the donee gave significant exposure and publicity to the donor, by associating itself in a very public announcement with the taxpayer. This *quid pro quo* suggests that the contribution was in fact not simply a donation, but had some more tangible objective and hence could not be treated as such. There is equally a presumption in law that where an agreement is not explicit, the contribution is not a donation\(^{62}\).

In order to determine whether the expenditure was incurred in the production of income, one must establish that an act was performed with the objective of earning income and that this act is sufficiently linked to the expenditure incurred so as to appear part of the cost of performing it. If we compare this to the *PE Electric Tramway* case then the act, which Watermeyer AJP describes, would be the donation made to the Urban Foundation. This act was not simply an undertaking to contribute to a worthy cause. If so it could have been done without any media attention. On the contrary, there was an explicit agreement that Pick ‘n Pay would receive significant publicity and media exposure. This was achieved through the very public announcement of the donation and the various media coverage gained.

The objective of the donation so far as Pick ‘n Pay was concerned, was to achieve this publicity (indirect marketing exposure) and further enhance its image as a company committed to social responsibility. This image, which it had undertaken to establish over the years, resulted in greater support and therefore income from its customers. The maintenance of this image through such publicity is therefore directly related to the extent of the support and income Pick ‘n Pay achieves from its customers.

While actually earning income is not a pre-requisite to show that expenditure is incurred in the production of income (*Sub-Nigel*), it was shown that the taxpayer enjoyed increased revenues for a period of several months after this publicity.

The expenditure incurred in making the donation was therefore directly linked to the publicity that was obtained and also to the benefit, which Pick ‘n Pay achieved from maintaining its image. The act

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\(^{60}\) *OVENSTONE v SECRETARY FOR INLAND REVENUE* (1980) 42 SATC 55

\(^{61}\) Ibid at page 737

\(^{62}\) *DE JAGER v GRUNDER* (1964) 1 SA 446 (A)
of the donation and the expenditure incurred thereon were clearly expended in the production of income. It had the effect of advertising for the company and thereby assisted the company in selling its products (ITC 696). This was confirmed by the decision of the court.

With respect to the capital / revenue nature of the payment the court found that the publicity gained was of a short-term nature. The company was required to continuously seek such methods of publicity in order to maintain its image in the eyes of the public. The need to continuously incur expenditure on advertising and publicity, rather than the duration of the effect of a particular marketing action reflected the short-term nature of such acts. There was no enduring benefit created by the expenditure (Palabora Mining Co Ltd) and it did not enhance the taxpayer's income earning structure (New State Areas Ltd).

Comparing this instance to the cases of ITC 217 and ITC 469, the expenditure incurred did not create a ‘tangible thing’ that could be used to display and sell the company’s products in future. There was, in addition, no source of future profits (George Forest Timber) acquired by the contribution, i.e. the donation or its effect could not be called upon at a later date to generate income. Its effect was immediate and in fact would dilute rather rapidly over a finite period.

The courts found that the expenditure incurred on the donation was revenue in nature. The difficulty in the court’s decision and whereupon the attending judges differed in their views related to the application of the s23(g) and the trade purpose of the taxpayer.

It is clear that an objective of the donation was to obtain publicity and further the business interests of Pick ‘n Pay. However what is not clear is whether there was a secondary objective, to contribute funds to a worthy cause. The Commissioner contended that this philanthropic motive was a dual purpose of the taxpayer in making the contribution and hence the donation could not have been made wholly and exclusively for the purposes of trade (as the section then read).

Mr Ackerman, who owned 30% of Pick ‘n Pay at the time, was also on the board of the Urban Foundation and in his role sought donations that would further their organisation’s cause. If we look at just Mr Ackerman, he possessed two objectives. The first, in his role as chairman of Pick ‘n Pay, was to achieve good publicity and further promote its business. The second, as a member of the Urban Foundation, was to procure funds through donations and put these funds towards charitable causes. As we saw in Solaglass Finance Company (Pty) Ltd vs. CIR the connected relationship between the taxpayer and the benefiting party helped to persuade the court that the taxpayer’s

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63 Ibid at page 140
purpose was not solely to make a profit through money-lending. Similarly the link that Mr Ackerman represents between the taxpayer and the foundation weighed heavily on the judges to find that the taxpayer did not have a single purpose behind the donation.

To determine the objective of the taxpayer (Pick 'n Pay) in making the donation, Nicholas AJA looked at the objective of Mr Ackerman. The taxpayer testified that Mr Ackerman had acted in two separate capacities, one as chairman of Pick 'n Pay and the other as a member of the Urban Foundation. In his obiter dictum Nicholas AJA says “A man does not change his mind when he changes his hat.” 64 In other words he was unable to accept that a man can act in separate capacities and with separate objectives. While this is debateable, what is more troubling is the fact that the judge accepted the actions and objectives of the chairman as being those of the taxpayer.

Who in this case was the taxpayer? Is it the director or shareholder acting on the taxpayer’s behalf? It was shown in Commissioner for Inland Revenue v Richmond Estates (Pty) Ltd 65, that the intentions of a company are represented not by its shareholders, but by its board of directors acting as such. While Mr Ackerman was on the board, he did not represent the entire board. The testimonies of the directors show that the decision to go ahead with the donation was made by the board for the purposes of achieving publicity and indirect marketing exposure. With respect it appears the court acted harshly in accepting the intentions of Mr Ackerman as those of the taxpayer.

Nicholas AJA notes the importance of distinguishing between object and effect. An action which genuinely has a trade objective does not disqualify treatment as such simply because it achieves another effect, one which is ancillary to the action’s purpose. Lord Brightman in Mallalieu v Drummond 66 states that “The object of the taxpayer in making the expenditure must be distinguished from the effect of the expenditure. Expenditure may be made exclusively to serve the purposes of the business, but it may have a private advantage. The existence of that private advantage does not necessarily preclude the exclusivity of the business purposes.”

This principle was applied by Lord Sumner in Usher’s Wiltshire Brewery Ltd v Bruce “Where the whole and exclusive purpose of the expenditure is the purpose of the expender’s trade, and the object which the expenditure serves is the same, the mere fact that to some extent the expenditure enures to a third party’s benefit . . . cannot in law defeat the effect of the finding as to the whole and exclusive purpose”.

64 Ibid at page 151  
65 COMMISSIONER FOR INLAND REVENUE v RICHMOND ESTATES (PTY) LTD (1956) SA 602(A)  
66 MALLALIEU v DRUMMOND (INSPECTOR OF TAXES) (1983) 2 All ER 1095
THE DONATIONS DILEMMA

Grosskopf J in the Special Court proceedings of the Pick ‘n Pay case takes this further saying “business which is conducted with friends, relatives or well-wishers does not cease to be business”.67 The important point from the above is that one cannot look at the effect of an action to determine its objective, since an action may have several subsidiary effects or secondary consequences (Bowden vs. Russell & Russell68 and Bentleys, Stokes and Lowless vs. Beeson69). One needs to determine the main purpose of the action and hence the corresponding effect, without which the taxpayer would not have entered into the transaction.

In the testimony of Mr Ackerman he was asked whether Pick ‘n Pay would still have made the donation had they not received the publicity. He replies: “We certainly would have made a donation but it would have been absolutely a R10 000 or R20 000 donation. It would have been a very big donation for us to have made. It would have been a donation to that category. Yes, we would have made one. But we went for this high figure as a package deal to really promote it strongly.”70 Hence it would seem that Pick ‘n Pay would nevertheless have made a donation but it would have been in the region of R10,000 or R20,000. The difference between R20,000 and R500,000 therefore, so far as Pick ‘n Pay was concerned, represented more than merely a donation but rather a payment for publicity and exposure.

This introduces another major argument on behalf of the Commissioner, that the taxpayer in fact had a dual purpose, the first to make a donation and the second to obtain publicity. As was discussed earlier in the cases of ITC 734 and Solaglass Finance Company (Pty) Ltd vs. CIR the existence of a dual purpose (one being for non trade purposes), disqualified the taxpayer from treating the expenditure as deductible in terms of s11(a).

The question must be asked in situations where there is more than one purpose, whether there can be a dominant and a secondary purpose. How could one identify between the two and can a dominant purpose mitigate one or several secondary purposes (Bowden vs. Russell & Russell). The courts would no doubt have to rely on the intention of the taxpayer at the time of the event, established by hearing the testimonies of the taxpayer’s representatives. The testimonies in this respect were given little weight due to their limited independence and the elapsed time period between the appeal and the event.

It was shown that Pick ‘n Pay undertook continuous and significant efforts to promote its image as the ‘consumers’ champion’ by supporting social causes and fighting inflation. The Commissioner

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67 Ibid at page 149
68 BOWDEN (INSPECTOR OF TAXES) v RUSSELL AND RUSSELL (1965) 2 All ER 258
69 BENTLEYS, STOKES AND LOWLESS v BEESON (INSPECTOR OF TAXES) (1952) 2 All ER 82
70 Ibid at page 147
maintained that the taxpayer’s objective was to link itself to a worthy cause and it did so by donating to the Urban Foundation. The taxpayer’s defence insisted that this was not the objective. The objective was publicity, which would generate customer support. The only way to achieve this publicity in line with the company’s image was by connecting itself to charitable causes. The principles of the Urban Foundation satisfied this criterion.

Nicholas AJA was unable to accept the notion that a company like Pick ‘n Pay could undertake a philanthropic act purely for profit motives. This he says was inconsistent with “the persona of the company... which Pick ‘n Pay has sought over the years, no doubt sincerely, to build up” 71. However there was always a reason why Pick ‘n Pay had in fact over the years established this image for itself, this being to differentiate itself from its competitors in a way that would bring it into the hearts and minds of its consumers. Hence the contribution and the publicity that the company sought to gain was in fact consistent with its historical behaviour and the reason for these actions. “Corporations expect to receive a commensurate benefit in exchange for any [charitable] transfer, by virtue of the “halo effect” created by the favourable public perception of transfers to charity.” 72

Emslie, T identifies two types of effect when looking at the relationship between a purpose and effect. The first effect is one that motivates expenditure and the second while still desired does not motivate expenditure73. From the testimonies it is evident that the taxpayer would have made a donation nevertheless, but certainly not to the extent that it did.

The publicity clearly motivated the expenditure of the amount of R500,000. The donation motivated expenditure up to an amount of say R20,000, but this must be seen as incidental when compared to the size of the total expenditure. The proportion of the probable “real donation” (R10,000 or R20,000) to the total expenditure represents between 2-4% thereof. One could not fairly say, for the sake of a 2% representation of the total expenditure, that a dual purpose existed and that such dual purpose taints the entire transaction with a secondary purpose.

The Contention that the taxpayer exercised a dual motive seems relevant when looking at Mr Ackerman due to his positions held with the Foundation and Pick ‘n Pay. It is difficult to conclude that this dual motive of the chairman can simply be attached to Pick ‘n Pay and therefore become the motive of the taxpayer, doing so nullifies the capacity of a board of directors, of which Mr Ackerman was only a part (albeit significant). From the taxpayer’s point of view the donation is the means to achieving its objective, i.e. the publicity. Of course the donation could never be said to be purely

71 Ibid at page 151 (emphasis added in italics)
72 Virginia Tax Review: Presented to you by ... Corporate Sponsorship and the UBIT; FALL 1997; page 402
73 South Africa Law Journal; Is generosity a bar to tax deductibility?; Volume 105; page 220
philanthropic as there would then have been no expressed requirement for the media coverage and publicity. In deed why would Pick 'n Pay have needed to make such a promise for R100,000 donation each year? They could simply have made the donation annually and if at any point they chose not to make the donation then this would have had no repercussions.

Under the amendment to s23(g) this would certainly have resulted in an apportionment of the expense between the two purposes, making the argument purely academic. However the point remains that where an affect is consequential or incidental to an action, then it should not alter the treatment of that dominant purpose.

The onus of proving that the expenditure was incurred with one main purpose and that this was in fact for trade rested on the taxpayer. The majority decision of the court found that the taxpayer had not discharged this burden and hence concluded that, on the evidence, there appeared to be a dual purpose to the expenditure. This was sufficient to warrant the application of s23(g). The section at the time required an either or application, as such the full amount of the donation was not deductible.

The minority decision concluded that sufficient evidence had been presented to decide in favour of the taxpayer. I believe in this case, as was shown in Solaglass Finance Company (Pty) Ltd vs. CIR, the connected relationship between the taxpayer and the recipient of the donation was a decisive factor, which diluted the integrity of the taxpayer's testimonies and ultimately its case. If Mr Ackerman had not been on the board of the Urban Foundation, it would certainly have been easier to discharge this burden of proof. Whether the result would have been different is unclear, but unfortunately the court in this case could not accept the evidence given in light of this circumstance.

6. WHERE IS THE DISTINCTION?

We have examined various instances of contributions given to organisations for publicity and advertising. Do the above cases make it any clearer as to when a contribution will be perceived as being expenditure incurred in the production of income, and for trade purposes? Are there any rules that will assist us in predicting when such a donation is seen as deductible?

The quid pro quo test is often mentioned as one, which should be utilised to determine if the receiving organisation performs valuable advertising, marketing or similar services for the sponsor. I.e. Where the donor receives such valuable advertising, then one cannot conclude that the donation or

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74 Virginia Tax Review; Presented to you by ...: Corporate Sponsorship and the UBIT; FALL 1997; page 404
sponsorship was entirely gratuitous. The problem with this test however is that it does not give sufficient indication as to the motive of the donor/sponsor.

In his article “Is generosity a bar to tax deductibility”, Emslie, T poses two examples to compare to the Pick ‘n Pay case. The first, where a company’s managing director sponsors a sporting event as a public relations exercise. The director is also the chairman of the associated sports club. In this example the purpose of the expenditure is to achieve publicity. The effect is to achieve this publicity and at the same time the sports club receives much needed sponsorship (secondary effect). In the second example, a company donates funds to a local orchestra with the purpose of promoting the company’s image and contributing to a worthwhile cause. The effect is therefore the same as the purpose.

The difference between these two examples is that the first has a single purpose, but achieves multiple effects. Hence we must distinguish between purpose and effect. One must ask the question, but for the effect achieved, would the taxpayer still have incurred the expenditure? If the answer is yes, then the effect is secondary and cannot be said to be part of the taxpayer’s purpose 75. Where the answer is no then one can conclude that there was no motive for this secondary effect. This technique ensures that only effects motivated by purpose are attributable to the donation or contribution.

From SARS perspective, would such a rule cater for donations made to institutions that are done so under the guise of a sponsorship? In this event, I believe we could still apply the enquiry. If it can be shown that a company would nevertheless have donated funds to an institution, regardless of the publicity or exposure obtained from the donation or the association created between the charity and itself then this is not a motivating purpose for the contribution. The burden of proof, in terms of s82, ensures that this task always rests with the taxpayer.

7. CONCLUSION

The above discussion has highlighted many factors that need to be considered when evaluating the deductibility of donations, sponsorships and contributions to charitable and sporting associations. It is clear that the distinction must always lie in the motivation or purpose of a taxpayer’s action, and for this as always, we are forced to look at the facts in each particular instance.

75 South Africa Law Journal; Is generosity a bar to tax deductibility?; Volume 105; page 220
Where the taxpayer is able to show that the motivation for sponsoring an event or making a donation to a cause is in the production of income and for trade purposes, then it will be deductible. How therefore does the taxpayer go about proving this or at least conducting his affairs in a way, which will record this intention if examined later?

Certainly there are some relevant lessons we can apply from the cases mentioned above. Particularly there will always be an added complexity where the contributor and receiving party are related parties. In such cases it would be in the taxpayer’s interest to ensure that any contribution agreement is contractual and that the reciprocal benefit to the contributor is expressly noted therein. In fact it would be advisable to have a contractual agreement for any such contribution regardless of the relationship. It must explicitly note the details of each of the parties’ obligations in terms of the agreement. This would help to satisfy the court as to the taxpayer’s motivated purpose at the time of the contribution, and hence relieve the taxpayer’s burden of proving the same through diluted testimonies, something to which the courts have attached low significance.

Still we must consider that a contribution will be classified as a donation if it is “made without an expectation of a return benefit commensurate with the amount of the payment.”\(^76\) Contributing to worthwhile causes is a noble and generous act for any individual or company, but how the law treats these actions will differ depending on the contributor’s intention. If the contributor expects to receive the tax benefit from such a payment then it is advisable for him to take sufficient steps to ensure this is applicable in the circumstances.

The procurement of sponsorships and donations for charitable and sporting institutions is an industry, which is still very unsophisticated and under-developed in our country. The growth of NGOs\(^77\) and other non-profit organisations (particularly in social welfare and education) formed to develop and improve the lives of the vast majority of our population will require increasing participation from the private and public sector to fund its objectives.

As this area of commerce develops so too will the complexity and issues governing the contributions to fund them. Businesses will be reluctant to provide financial support to these organisations without receiving some form of commercial advantage. Without any amendments to our current legislation there may well be a need for adequate tax planning to ensure that businesses and society can gain from this form of philanthropy.

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\(^76\) Ohio Northern University Law Review; Section 513(l) of the internal revenue code; 1999; page 4

\(^77\) Non-Governmental Organisations
Conversely it may be that we must accept the capitalistic idiom that sponsorships and donations “are rarely charitable or philanthropic. They are business deals where sport (or the charitable organisation) sells itself as a desirable vehicle for publicity.” In such case it will be up to us to reflect this in our dealings with both these charitable or sporting organisations and the governing bodies that administer our legislature.

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78 My addition: (or the charitable organisation)

79 Melbourne University Law Review; Structuring effective sponsorships; April 1999; page 1
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