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## **ABSTRACT**

The study examined tax legislation that affects Public Benefit Organisations (PBOs) with specific emphasis on sports organisations.

The relevance of the legislation was examined and secondly, where applicable, a review on how specific sports organisations (PBOs and recreational clubs) implemented the tax legislation was performed. A detailed analysis of the national and international sports environment was presented in order to inform the study. This was followed by a comprehensive examination of each section of the Income Tax Act in relation to PBOs and sport. A brief comparative study was also undertaken to benchmark South Africa against countries playing the same or similar sports. As the tax on Public Benefit Organisations is a relatively recent tax, little or no analysis has yet been conducted on its relevance and the implementation thereof.

This study served to critically analyse the implementation of this tax by sports organisations using the limited data available in the public domain.

The results revealed that the legislation is excessive, particularly for recreational clubs, taking into consideration South Africa's sporting development needs.

In support of the findings, it is recommended that the Treasury consider separating the legislation affecting sports organisations from legislation affecting other Public Benefit Organisations.

## GLOSSARY OF TERMS

CAF	Confederation of African Football
CASC	Community Amateur Sports Club
CGF	Commonwealth Games Federation
CSA	Cricket South Africa
CSARS	Commissioner of Inland Revenue
CWC	Cricket World Cup
DTA	Double Taxation Agreement
FIFA	Federation of International Football Association
GST	General Sales Tax
HM R & C	HM Revenue and Customs Service
ICC	International Cricket Council
IFRS	International Reporting Standards
IOC	International Olympic Committee
IPL	Indian Premier League
IRB	International Rugby Board
ITA	Income Tax Act 1962 as amended
NGO	Non-Governmental Organisation
NPC	Non Profit Company
NPO	Non-Profit Organisation

PAYE	Pay As You Earn
PBA	Public Benefit Activity
PBO	Public Benefit Organisation
RWC	Rugby World Cup
SA	South Africa
SARFU	South African Rugby Football Union
SARS	South African Revenue Service
SARU	South African Rugby Union
SASCOC	South African Sports Confederation and Olympic Committee
SACOS	South African Council of Sport
SANROC	South African Non-Racial Olympic Committee
SR	Super Rugby
SRSA	Department of Sports and Recreation South Africa
TAA	Tax Administration Act
TEU	Tax Exemption Unit
Tri	Tri-Nations Rugby
TV	Television
UCBSA	United Cricket Board of South Africa
VAT	Value Added Tax
WPCA	Western Province Cricket Association





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# Chapter 1

## INTRODUCTION

### 1.1 Introduction to Sports Federations and Sports Clubs in South Africa

The taxation of South African sports organisations is fairly new in South Africa.

Until the appointment of the Katz Commission in 1994, sports organisations enjoyed an income tax “holiday” and were exempt from paying tax. In 2000, the former Minister of Finance Mr Trevor Manuel introduced the concept of a Public Benefit Organisation (PBO).

Even though recreational clubs were earmarked for income tax in 2000, the conditions for taxation were never published. In 2006, recreational clubs were brought into the tax net.

### 1.2 The Purpose and Value of the Research

The purpose of the research is to analyse the existing tax legislation as it relates to sports organisations and recreational clubs. This analysis seeks to establish whether the applicable taxing regime is appropriate for such bodies in the South African context. As different structures can be chosen to conduct sporting activities, a secondary aim of this research is for it to serve as a reference guide for all sports organisations and recreational clubs. It will present clear and unambiguous guidelines on the most efficient corporate tax structure relevant to such organisations.

### 1.3 Method of Research

The method of research used in this study is doctrinal in nature and combines reform-orientated research with a theoretical approach. This method serves to evaluate adequacy of existing rules (the legislation) and recommend changes while at the same time enabling a focus on a thorough understanding of basic principles, legislation and the application thereof in a particular area, that of sports bodies.

Each chapter deals with a topic central to the taxation of sports organisations and recreational clubs. This research examines the situation prior to the introduction of the taxation provisions, the growth of sport in South Africa and globally, the implementation of the relevant taxes and the inadequacies in the current legislation.

The methods utilised include interrogating various sections of the Income Tax Act No 58 of 1962 as amended that are applicable to sports organisations, and reviewing the relevant case law and documents available in the public domain. Reference is made to international articles and foreign legislation, where appropriate, to compare the taxing of the selected sports bodies in South Africa against international standards in order to establish a benchmark.

#### 1.4 Limitations to the Research

This dissertation focuses specifically on the taxation of sports organisations based in South Africa. It does not deal with the taxation of sports persons. Furthermore, the research does not deal with the taxation of foreign sports organisations that have hosted events in South Africa.

## Chapter 2

# TAX LEGISLATION APPLICABLE TO THE TAXATION OF SPORTS BODIES IN SOUTH AFRICA

## 2.1 A Historical Analysis of the South African Sport Scene up to 2000

### 2.1.1 Growth in Sport Globally

South Africa's sporting history dates back more than 150 years. It is important to question at what point does sport become a business and by what means is it categorised as such? In "The Business of Sports"<sup>1</sup> the authors acknowledge the existence of a direct link between business and sport. The rise of sport in its modern form in the late nineteenth century brought with it entrepreneurs who sought to make profit from organising events and building facilities. In America, the idea of paying players existed from the beginning, but in Britain the amateur ethos remained strong, explicitly rejecting the idea of commercialising sport. Going back to the very beginning in 1888, the first international cricket tours to and from South Africa were privately-funded as entrepreneurial ventures. But it was the advent of televised sport in the 1960s that gave games the commercial value we see today. Companies like Adidas and Nike became mega corporations and the sports sponsorship market exploded. Sport became the target of large businesses. By the late 1980s and early 1990s, elite sports people and sports teams had become tradeable commodities.

Since the 1990s, sport as a business has grown exponentially. The rise of marketing agents, appointed by sports organisations and players to manage their marketing, like the International Marketing Company, headed by Mark McCormack who is widely regarded as the pioneering sports marketing and management guru, reflected the new era of sport as business.<sup>2</sup>

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<sup>1</sup> Rosner, S.R. & Shropshire, K.L. *The Business of Sports* (Sudbury, MA: Jones & Bartlett Learning, 2011). P12.

<sup>2</sup> Westerbeek, H. & Smith, A. *Sport Business in the Global Marketplace* (Houndmills, Basingstoke, Hampshire: Palgrave Macmillan, 2003). P 1.

Another example of sport and business was the spectacular “Rumble in the Jungle” boxing match-up in Zaire in 1974 featuring the legendary Mohammed Ali and George Forman organised by boxing promoter Don King.<sup>3</sup> The Ali/Forman fight netted USD five million for each fighter<sup>4</sup>, which in present day currency is estimated at USD 24 million. This pales in comparison to the recent Manny Pacquiao and Floyd Mayweather boxing match where the prize money was estimated to be between USD 220 million and USD 230 million<sup>5</sup>.

## 2.2 South African Sport Before 1991

South Africa suffered hugely from the imposed international sport boycott because of its apartheid policies. The ban was instituted in the 1970s and lifted in the early 1990s.

South Africa largely missed out on the growth of professionalism in the 1970s and 1980s because it had been expelled from international competition because of apartheid. It found itself isolated from all the major international sport competitions, with the endorsement of internal sports organisations like the South African Non-Racial Olympic Committee (SANROC) and the South African Council of Sport (SACOS) who were aligned to the liberation movement and saw the importance of using sport to leverage societal change.<sup>6</sup> Only a few establishment sports people managed to escape the ban, mostly with the help of conservative friends from the western countries. South Africa was excluded from the Olympic Games by the International Olympic Committee (IOC) and from soccer’s World Cup by the Fédération Internationale de Football Association (FIFA).

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<sup>3</sup> Ibid.

<sup>4</sup> Rothman, L. "How Muhammad Ali Won the 'Rumble in the Jungle'," *Time*, October 30, 2014.

<sup>5</sup> MacNair, A. "Floyd 'Money' Mayweather Makes Bank from Pacquiao Fight with \$230 Million Purse", *Mmama.com*, last modified 2015, accessed November 17, 2015, <http://www.mmamania.com/2015/7/5/8894879/floyd-money-mayweather-makes-bank-from-pacquiao-fight-with-estimated>.

<sup>6</sup> Jeffery, S. "Timeline: sporting boycotts," *The Guardian*, December 30, 2002, accessed November 20, 2015, <http://www.theguardian.com/world/2002/dec/30/zimbabwe.politics>.

The only notable competitions that continued featured “rebel” rugby and cricket teams.<sup>7</sup>

### 2.3 South Africa Re-admitted into World Sport

South Africa was re-admitted into the international sports arena in 1991 and by the time the country held its first democratic elections, all sporting organisations representing different sports codes (the different types of sports) were re-admitted into international sports organisations or world controlling bodies.

Re-admission into international sport could not have come at a more opportune time for South Africa as sport was experiencing tremendous growth globally.

The explosion was due mainly to the globalisation of sport and the rapid growth in digital television (TV) led by media moguls such as Rupert Murdoch. As a result, twenty-four hour [24] digital television soon became the worldwide norm. Sports and television complemented each other and consequently, over time sport progressed to digital 24 hour coverage.

Rupert Murdoch led the assault on acquiring an interest in major sports organisations. He made an unsuccessful attempt to buy the Manchester United Football Club.<sup>8</sup> The bid was made in order for him to acquire exclusive television rights; however, the United Kingdom’s competition authorities rejected his offer to buy the world’s most famous football team as it was seen as anti-competitive.<sup>9</sup> Murdoch owned BSkyB, host broadcaster of football matches in the UK; if he was awarded the bid his undue influence on the sport would increase.

Sport became thoroughly commercialised and sportsmen and women throughout the world began to use sports agents and sports marketing

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<sup>7</sup> South African Cricket Team 1 October 2015. Available <http://www.supersport.com/cricket/international/south-africa-cricket-team-info>. Accessed: 22 November 2015.

<sup>8</sup> Ibid 2 P 90.

<sup>9</sup> Larsen, P.T. & Grice, A. "Murdoch's Man Utd Bid Blocked", *The Independent*, last modified 1999, accessed March 31, 2016, <http://www.independent.co.uk/news/murdochs-man-utd-bid-blocked-1086123.html>.



companies. Digital television opened up all sorts of opportunities for sports bodies. For example, pay per view, 24-hour coverage and an extensive range of live sport offerings. Major sports federations such as the IOC, FIFA, the International Rugby Board (IRB) and the International Cricket Council (ICC) quickly latched on to the growth possibilities arising from this next phase of the television age. One unfortunate consequence was, however, a dip in the number of spectators watching live sport.

FIFA is currently in crisis as a result of claims that its officials and executive members accepted bribes in awarding the Soccer World Cup to various countries. This follows investigations by the Internal Revenue Service of the United Kingdom (HMRC) and the Federal Bureau of Investigations in the United States (FBI). The investigations revealed that television was the largest money-spinner for FIFA as the Association earns a substantial income because it holds the sole TV rights for the global showpiece, the World Cup, played under its auspices.<sup>10</sup>

FIFA reportedly has a current income reserve of USD 1, 5 billion. Television revenue currently outstrips revenue from sponsorships, gate revenue and other income streams.<sup>11</sup>

The growth in TV revenue was aptly illustrated in a Sunday Times survey published on 31 May 2015.<sup>12</sup> The survey revealed that in 2002 FIFA's share of TV revenue was USD 706 million. In 2015 it earned USD 2,5 billion through television. It is clear that television revenue has become a major source of revenue for sports federations.

In South Africa in the 1990s, digital and pay-TV sport channel, SuperSport, emerged as the local equivalent of Rupert Murdoch. SuperSport grew significantly as a business and to protect its market share in South Africa it entered into equity deals with a number of sports bodies in order to secure

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<sup>10</sup> The Fédération Internationale de Football Association FIFA, *Governance Finances Financial Report* (Zurich: FIFA, 2015), accessed November 23, 2015, <http://www.fifa.com/governance/finances/index.html>.

<sup>11</sup> *Ibid* 7.

<sup>12</sup> Sunday Times, "Sponsors step up pressure on FIFA," *Sunday Times*, May 31, 2015, P 6.

television coverage of major events.<sup>13</sup> This was in line with international sporting channel trends, where sport delivers a 24-hour broadcast window due to the varying global time zones.

After South Africa's re-admission into international sport, revenue from digital television rose appreciably. This was illustrated by the 'Increased Income streams report' of the Western Province Cricket Association (WPCA) soon after unification in 1991. All major sports bodies reported an increase in revenue. These were followed by all major income streams that reflected growth above inflation.

## 2.4 The Appointment of the Katz Commission<sup>14</sup>

As the boundaries between traditional amateur and professionalism became blurred and sport became a major business e.g. Super Rugby, the first democratic government launched an investigation into the South African tax structure.

In 1994, a Commission, headed by Michael Katz, was set up to do this. Finance Minister, Mr Trevor Manuel, explained in his address to the Annual Conference of the International Bar Association on 24 October 2002, that the investigation covered all aspects of the South African taxation system.

The Katz Commission also investigated the Non-Profit Organisation (NPO) sector of society in South Africa, a sector where sport was included. After thoroughly investigating the sport sector, the Commission recommended a number of changes. The Commission paid tribute to the NPO sector and the work it carried out. However, the Commission pointed out that the playing fields had to be levelled when NPOs were measured against other businesses that were required to pay tax.<sup>15</sup>

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<sup>13</sup> IOL, "Sharks keep their head above water," *IOL*, May 21, 2004, <http://www.iol.co.za/sport/sharks-keep-their-head-above-water-535218>.

<sup>14</sup> Refer to Appendix 1 [P 96-P 104] for a detailed discussion on the Katz Commission.

<sup>15</sup> Department: National Treasury, *Katz Commission Report, Ninth Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa*, (Johannesburg: Department: National Treasury, 1999), <http://www.treasury.gov.za/publications/other/katz/9.pdf>.

## 2.5 Introduction of Public Benefit Organisations

In the 2000 Budget Speech, the Minister of Finance introduced the concept of the Public Benefit Organisation.<sup>16</sup> Until the year 2000, amateur sports organisations were exempt from tax as per section 10(1)(k) of the Income Tax Act as all bodies were considered amateur.<sup>17</sup> The Minister of Finance had the authority to rule when a sports body was engaged in professional sport and as a result, determined whether a sports body was an amateur or professional sports body.

South Africa has a rich history of sport. Club rugby, cricket and football was played in the late 1800's and certain clubs have been in existence for more than 150 years.<sup>18</sup>

It was during this time that the status of sport, from a tax perspective, was changed. Taxation on profits meant that sports bodies had to alter the way they operated to remain profitable and minimise tax liability.

Initially, the legislation forced sports bodies to split their operations into two distinct operations, (1) dealing with professional sport and (2) with amateur sport. It is important to bear in mind that professional sport has always been taxable; although the South African Revenue Service (SARS) did not entirely apply the rules resulting in professional sport sometimes being regarded as amateur sport.

Changes were also mooted in respect of amateur clubs or recreational clubs, although the regulations were never published. This was only brought into line in 2006.<sup>19</sup> Recreational clubs therefore, had a tax-free regime until 2007.

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<sup>16</sup> Manuel, T. A. "Budget Speech 2000." Speech, Annual National Budget Speech, Department: National Treasury, Cape Town, February 23, 2000. P 20.

<sup>17</sup> All references to the Income Tax Act in this study refer to the Income Tax Act No 58 of 1962, unless otherwise specified. The current Income Tax Act No 58 of 1962 as referred to in this study, includes Taxation Laws Amendment Act 31 of 2014.

<sup>18</sup> [Hamiltonsrfc.co.za](http://www.hamiltonsrfc.co.za), "History of the Club", last modified 2015, accessed September 5, 2015, <http://www.hamiltonsrfc.co.za/club/>.

<sup>19</sup> Manuel, T. A. "Budget Speech 2006". Speech, Cape Town, 2006. Accessed 26 August 2015. P19. <http://www.treasury.gov.za/documents/national%20budget/2006/speech/speech.pdf>.

Sport bodies split new operations by retaining the amateur bodies to look after the development side, which often retained the major asset in the organisation for example, the stadium.<sup>20</sup>

The professional side of sport was moved to a formal corporate structure, which was in many cases, a private company. The company carried out all transactions affecting the so-called “professional side” of sport.

In the run-up to the legislative changes, South Africa was the subject of intense interest mainly as a result of a peaceful transformation and the profound influence of the first democratically elected President, Mr Nelson Mandela.

South Africa was immediately awarded the rights to host the 1995 Rugby World Cup, which it went on to win. Major international and local sponsors threw their weight behind South Africa. The new democracy paved a gateway for sponsors to Africa due to the vast potential for growth.

The tourism industry benefited significantly from the resurgence of South African sport.<sup>21</sup> This was further enhanced as South Africa successfully bid to host the 2003 International Cricket Council World Cup and the 2010 FIFA Football World Cup. However, Cape Town’s bid to host the Olympic Games in 2004 was unsuccessful.

The successful awarding of the 2010 FIFA World Cup to South Africa was not only an achievement for South Africa but also for the greater African continent. It provided a business platform for major international sponsors to invest in sport in South Africa. Consequently, this provided tourism with a major boost and allowed South Africa to upgrade its infrastructure, which was in need of repair.

The construction industry acquired major contracts for stadia and road and rail networks were upgraded. The upgrades provided employment opportunities,

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<sup>20</sup> There are a number of sports bodies that do not own stadiums and often lease the stadium from municipalities.

<sup>21</sup> "South Africa's Tourism Industry," South Africa's Official Gateway - Investment, Travel, Country Information, accessed June 20, 2015, <http://www.southafrica.info/business/economy/sectors/tourism-overview.htm#sport>.

albeit only for a short term. The number of tourists visiting South Africa during the 2010 FIFA World Cup saw a dramatic increase.<sup>22</sup>

Individual sportspersons also benefitted from the resurgence in sport. Prior to 1991 individual sports people were precluded from competing outside of South Africa as a result of the imposed sports boycott.

Now, local players could ply their trade worldwide without restraint. Teams could now participate in overseas tours and South Africa was re-admitted to the Olympic fraternity in 1992.

South African sport also benefitted from a strong foreign currency as the South African rand weakened appreciably. Most sports deals are concluded in U.S. dollar and in some cases British Pound or Euro.<sup>23</sup> Furthermore, a large influx of sport tourists resulted in increased international tours to South Africa. The rising popularity of sport tourism increased income for South African sport in the form of foreign currency. This also resulted in a sharp increase in sponsorship income. Sports bodies had been required to invest large sums of money in infrastructure and development. But under the apartheid regime and the resultant international sports boycott, sport stadia suffered from a lack of investment. As a result, key sports stadia were in a state of disrepair or were inadequate to host international events. It was for these reasons that capital had to be raised, sometimes in unconventional ways to finance capital improvements to stadia.

Municipalities and the government, both at provincial and national level invested large sums of money to upgrade stadia. Due to the structural economic imbalances under apartheid, there was a massive disparity in the quality of sports facilities and equipment. The government, at various levels, and the sports bodies put in a mammoth effort to address these disparities.

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<sup>22</sup> Department: Sport and Recreation. *2010 FIFA World Cup Country Report* (Pretoria: Department: Sport and Recreation, 2011).

<sup>23</sup> Alfred, L. "Playing for the Bucks", *Financial Mail*, 2015, accessed January 18, 2016, <http://www.financialmail.co.za/life/2015/07/16/playing-for-the-bucks>.

Sports bodies were required to employ more people and engage service providers in upgrading and upskilling people and facilities so that all South Africans could compete on an equal footing.

This forced sports bodies to allocate large sums of money for sports development and sports bodies continue to invest in development to the present day.

Most of the increased revenue derived from sponsorships, gate revenue, and advertising and TV revenue were allocated to the development of sport in the poorer areas of South Africa.<sup>24</sup>

Many international sports persons came to South Africa to ply their trade. Sports bodies were now free to engage international sportspersons so as to bolster their ranks. Several foreign sports clubs resumed tours to South Africa; in some instances using South Africa as a pre-season training venue.

Later, the National Lottery provided funding for certain sports bodies.

The issue as to whether sport was a business or not was widely debated. Had sport crossed the divide? Many believe sport is a business where rich businessmen seek ego-boosting activities on the one hand, and on the other, try to run sports bodies on a professional basis.

Professor Ross Tucker stated, in his weekly column in The Times in response to the latest crisis regarding FIFA, that in his experience, "sport is a magnet for this power seeking behaviour."<sup>25</sup>

Given the widespread corruption in sport one can only reach the conclusion that professional sport is required to remit its taxes. This could, in a small way, gain the confidence of the paying public.<sup>26 27</sup>

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<sup>24</sup> Majola, G. "Cricket Transformation: 2002/3 Season Presentation by Gerald Majola, Chief Executive Officer to the Parliamentary Portfolio Committee Sport and Recreation", 2003.

<sup>25</sup> Tucker, R. "The Hunger Games," *Times Live*, June 2, 2015.

<http://www.timeslive.co.za/thetimes/2015/06/02/The-hunger-games>.

<sup>26</sup> Boykoff, J. & Tomlinson, A. "After the World Cup Final, this is How to Stop Fifa from Being Such a Parasite", *The Guardian*, 2014, accessed March 25, 2016,

<http://www.theguardian.com/commentisfree/2014/jul/13/world-cup-final-fifa-brazil-football-tax-breaks>.

## 2.6 The South African Sports Structure

It is necessary to undertake a brief analysis of the sports structures that exist in South Africa before a review of the legislation applicable to sport bodies is presented.

The Department of Sport and Recreation (SRSA) is the national government department responsible for all sport in South Africa.

SRSA does not sponsor individual athletes but rather sponsors federations and clubs. The Department gets legal authority from the National Sports and Recreation Act 110 of 1998.

## 2.7 South African Sports Confederation and Olympic Committee

The South African Sports Confederation and Olympic Committee (SASCOC) is the coordinating sports body for all multi-coded international events such as the Olympic Games, Commonwealth Games and the All Africa Games. SASCOC is responsible for all National Sports Federations in South Africa as well as Provincial Councils of Sport.

The Committee also awards national colours for all sporting codes in South Africa. The Protea, the national flower of South Africa, is also the South African Sports emblem.

Sportspersons representing South Africa under SASCOC do not get paid. However, upon conclusion of major sporting events, SASCOC pays performance bonuses to players.

SASCOC as well as all national federations are obliged to enter into a service level agreement with SRSA. The service level agreement commits the signatories to assisting SRSA with development and training of club sport and high performance activities among other undertakings.

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<sup>27</sup> Edholm, E. "NFL to Give up Tax-Exempt Status amid Congressional Pressure", Yahoo Sports, last modified 2016, accessed March 25, 2016, <http://sports.yahoo.com/blogs/nfl-shutdown-corner/report--nfl-to-give-up-tax-exempt-status-amid-congressional-pressure-172126574.html>.

## 2.8 National Sports Federations

All sports codes in South Africa have a national federation or affiliate. These bodies are autonomous and responsible for the running of that sport in South Africa. Some of the biggest sports organisations are Football, Rugby and Cricket. These receive the most revenue, a fact that has often been criticised. Smaller sports organisations battle financially because they do not receive substantial income from sponsorship, gate revenue and spectator support. These organisations can choose to register as a PBO, where they only administer amateur sport or be taxed as a normal company and take advantage of section 11E and section 24E of the Income Tax Act.

## 2.9 Provincial Sports Bodies

There are umbrella provincial Sports Councils as well as provincial sporting bodies for each sport in every province. The provincial sports bodies are in turn affiliated to the national bodies. These bodies coordinate sport within the provinces. Some provinces, for example Southern and Northern Gauteng, may have more than one provincial body due to its size and location. National bodies are generally feeder bodies to the provincial counterparts. Often the national bodies organise income streams that are passed onto the provincial bodies. Certain provincial sports bodies cater for both amateur and professional teams; however the majority are amateur in nature. Amateur sports bodies may apply to be registered as a PBO or alternatively be taxed as a company.

## 2.10 Clubs

Clubs (recreational clubs) are where grassroots sport is played. South Africa has a diverse collection of sports clubs that vary in size and income status. Some clubs are fully professional like some football clubs. Football clubs include both professional and amateur clubs; however all other sporting clubs are considered amateur in nature. Recreational clubs are bound by special taxation rules and are obligated to register with SARS.



## Chapter 3

### TYPES OF INCOME ACCRUING TO SPORTS BODIES

#### 3.1 The Tax Treatment of Various Types of Income of Sports Bodies and Recreational Clubs

The rules governing PBOs and recreational clubs set out the narrow band in which income received is taxed or not taxed.

In order to understand the tax regime that is applicable to PBOs and recreational clubs, it is important to first consider the various types of income earned by these structures. This dissertation deals separately with general sports bodies and recreational clubs. Generally, income received for amateur sport will be exempt from taxation. Income applied to (or received for) professional sport will be taxable. PBOs need to be approved by the South African Revenue Service (SARS) because if they are engaged in amateur sport they are not taxable entities. PBOs are allowed to participate in certain business or trading activities, subject to conditions, and still retain their exempt status.

##### 3.1.2. Sport Bodies

As it has been previously stated, sports organisations that administer professional sport will be taxed under the normal tax rules.

In order to qualify as a PBO, the sports body has to comply with the provisions of the Income Tax Act (ITA). Section 10(1)(cN) of the ITA sets out the rules pertaining to the taxation of income for these bodies. This section clearly states that any income received from a business or activity is taxable. However, if the sports body can demonstrate that the income received is not based on a profit motive, the income will be exempt from tax. The sports body must show that income received is applicable to the PBO and income received has been calculated on a cost recovery basis and has not resulted in unfair competition with other taxable entities. The last condition of the section

is generally not applicable to sports bodies, as the activity is of an occasional nature.

### 3.1.3. Membership Fees

Most sport bodies require that affiliates pay a membership fee upon registration. Such fees are often nominal and tax-exempt as they fall into the definition of shared income.<sup>28</sup>

### 3.1.4. Sponsorship

Most major sports bodies receive sponsorships. The value of these has grown substantially over the last 20 years. Sponsorship money is used for development of the sport and other purposes. Occasionally, separate sponsors are requested to specifically support development.

Since the change to the PBO regulations in 2007, sports bodies can be both a taxable entity and a PBO. This means that they can be liable for potential tax in terms of their philanthropic income and expenditure.

Clearly sponsorship income used specifically for development is deductible for income tax purposes (tax neutral). However, this is only the case if the sports body is registered as a PBO and complied with the regulations. All other sponsorship income will be taxable.

It is clear that sponsor income is earned and in return certain benefits are given. These include, naming rights to the professional team, players' wearing apparel with sponsor markings and attendance at sponsor functions. Sponsors also receive complimentary tickets to matches, which are often used for promotional purposes to entertain clients and guests. It is clear that sponsorship income of this nature is not used for philanthropic purposes. Yet, sometimes a sponsorship will state that part of the patronage has to be allocated to development.<sup>29</sup> This clearly is allowed as tax-free income.

What is not clear in the legislation is whether the surplus will be taxed or is it

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<sup>28</sup> Section 10(1)(cN)(ii).

<sup>29</sup> Ibid 29.

subject to the further allowance in section 24E? (Discussed in Chapter 4)

### 3.1.5. Income from the Sale of Television Rights

Income from television rights is a considerable source of income for sports organisations. This source of income has grown substantially with the introduction of digital or pay television.

Television companies such as SuperSport rely on copious amounts of sports events to fill their content channels. Sport fulfils this need and given South Africa's sporting culture, it is clear that this is a significant revenue generator.

In addition to the sale of local television rights, sports bodies are given the television rights to incoming international tours. This is often much more lucrative than revenue earned from local television companies. Taking into account South Africa's weak exchange rate in relation to international currencies, the income received becomes substantial.

This is further enhanced by certain incoming tours which are much more lucrative than others. In cases where international tours have a wide spectator following, there is the potential for a greater income.

This results in a fluctuation in income from year to year. The problem sports bodies encounter is that all income received by the sport body can be taxed in South Africa regardless of the source.

It has been debated as to whether these fluctuating incomes are subject to any type of "smoothing" allowed in section 24E of the Income Tax Act (this is discussed further in chapter 4).<sup>30</sup>

In addition to the team and union sponsors, event sponsorship is another form of patronage. This type of sponsorship may include an element for sport development. Cognizance has to be taken of this by the sports body concerned.

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<sup>30</sup> Cricket South Africa interestingly indicates in the Taxation Note in its Annual Financial Statements, that the fluctuation in income falls within the terms of section 24E.

Development normally gives the sponsor mileage around the main event.

It is clear that the taxation of sponsorship income revolves around the tax status of the sports body. A PBO may procure sponsorship income as long as it is used for amateur sport.

### 3.1.6. Advertising

Sports bodies sell advertising rights linked to sporting events. Over the last 20 years, through the advances in digital advertising and 3D technologies, this market segment has expanded dramatically.

As a result of the extensive television coverage of sporting events, advertisers pay top dollar for coverage. Advertising is normally sold by sports marketing companies. Sponsors of the sports organisations generally receive prime coverage, as do the event sponsors.

A variety of advertising categories have been developed to exploit television coverage at sports venues. These include the standard advertising board, a field painted with advertising, digital advertising and promotional goods handed out to spectators attending the event.

Major events receive a “clean stadium” where advertisers associated with the event are allowed to advertise both in and outside the stadium. At international events an area around the stadium is set aside to prevent competitor advertising.

Advertising does not normally make provision for a development angle. In the event that advertising has been sold on a commercial basis, the income received becomes taxable.

### 3.1.7. Income from Ticket Sales

The sale of tickets to the general public is the most common generator of revenue.

Various forms of ticket sales take place:

- Season tickets - sold to the public in advance of a season. This is a fairly popular form of income for major sports bodies.
- Day tickets – sold on the day of the match.
- Debentures<sup>31</sup> – normally sold to raise funds for capital expenditure in the form of loan capital. In lieu of interest, the holders of a debenture will receive a full season ticket. Generally, companies and individual supporters take up the allocation of debentures.

All forms of ticketing for major events are taxable. Again, if ticket prices are based on a commercial basis, it will be taxable. However, if the proceeds of tickets sales are applied to amateur sport, the income will not be taxable.<sup>32</sup>

### 3.1.8. Income from Suite Sales

Following South Africa's re-admission into international sport, sports bodies had to upgrade their spectator facilities.

This required finance to pay for the upgrade of the facilities. Suites for prospective corporates were built above the general spectator facilities. This generated an income on a medium term basis, as these contracts were for a five to ten year period.

Various discounting modules were put in place to finance the cost of upgrading the facilities. Income accrued to the sports bodies is clearly taxable as trade income. Corporate companies entering into contracts receive certain rights including a parcel of match tickets. These tickets are used to entertain customers and clients. Normally, the sports body is allowed to place an advertising board in the front terrace of the suite. Generally, this type of advertising is charged on an annual basis which is taxable as trade income.

Occasionally suites are rented out on an annual basis to sports marketing companies, especially during major sport tours. This is especially relevant during major international tours to South Africa.

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<sup>31</sup> *Oxford Dictionaries - Dictionary, Thesaurus, & Grammar* "Debenture - Definition of Debenture in English from the Oxford Dictionary," accessed 13 March 2016.

<sup>32</sup> [http://www.oxforddictionaries.com/us/definition/american\\_english/debenture](http://www.oxforddictionaries.com/us/definition/american_english/debenture)  
 Ibid 29.

The organisers of large sporting events such as the Olympic Games and World Cups normally require a “clean stadium”. In such cases, suite holders are required to negotiate a new deal or pay for tickets and usage of the suites, as these are usually scheduled in the contracts. Generally the suite holders are required to relinquish their rights in respect of any advertising during these events.

Contracts are normally based on a market related cost with a market related mark-up. However, if it is not based on a cost recovery it will be regarded as a trading activity and is fully taxable in the hands of the Sporting Body.

### 3.1.9. Hosting Fees Required

National and provincial sporting bodies generally receive hosting fees when major events are hosted. International bodies such as the IOC, FIFA, ICC and IRB pay dividends to leading Federations. These dividends are based on the profitability of the events.

The fees are usually paid prior to the event to assist the sports organisation and working capital amounts are also paid during the event, based on the projected profitability of the event. Once the event has been concluded, further amounts are paid out based on the actual profitability of the event.

All major sporting events held in South Africa and hosted by key sports bodies have been highlighted as successful and profitable.

In the 2011 annual financial statements, FIFA reported that “FIFA placed its trust in South Africa, from the very start and the organisers made sure that the event was a success by building a partnership that was always based on respect, efficiency and solidarity. The 2010 FIFA World Cup™ in South Africa was not just successful from a sporting point of view, however, as it also underlined the immense social and cultural power of our game.”<sup>33</sup>

The Head of the FIFA finance committee, Julio H. Grandona, stated in the same report that “Even as 2009 drew to a close, there were signs that the

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<sup>33</sup> The Fédération Internationale de Football Association (FIFA), *FIFA Financial Report 2010* (Zurich: FIFA, 2011).

four-year cycle would not only be a sporting success but also leave FIFA on a solid footing. Ultimately, however that depended on the FIFA World Cup in South Africa being a success and silencing the many critical voices that were heard right until the end. We all know how it turned out.” South Africa thrilled the fans all around the world with an impeccably organised and colourful World Cup as well as their incredible hospitality. The stadia were initially sold out (to 97% capacity) and the sponsors were delighted, which ensured that the tournament was a financial success for FIFA and the Local Organising Committee (LOC). FIFA closed the 2007 – 2010 period with a result of USD 63 million and also increased its reserves to USD 1.28 billion.”<sup>34</sup>

It is clear that FIFA was very happy with the financial return it achieved in South Africa. In addition, FIFA committed to spend USD 100 million in South Africa.

In addition to the successful FIFA 2010 World Cup hosted in South Africa, both the International Rugby Board and the International Cricket Council held successful World Cups in South Africa in 1995 and 2003 respectively.

South Africa has prepared a bid to host the 2022 Commonwealth Games in South Africa and is in the process of submitting a bid to host the 2023 IRB Rugby World Cup.

Hosting fees received for hosting major events are taxable in the hands of the sports bodies. However, by way of section 24E of the Income Tax Act, this income may be smoothed over a period.

In terms of section 24E of the Income Tax Act, where the national body receives a distribution from hosting in respect of development, this income will be free from taxation.

It is imperative for sporting bodies to plan how income receivable from hosting can be properly allocated in order for it to be tax-free such as for expenditure on development.

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<sup>34</sup> Ibid. Page 9.

Sports organisations may also receive a share of hosting fees from events held in other countries. This is the case with FIFA World Cup and ICC Cricket World Cup. Proper planning can result in the sports bodies receiving allowances under section 11E and section 24E which will reduce their tax liability.

#### 3.1.10. Revenue from Alcohol Sales

Provincial sports organisations, who own or lease stadia, will receive income from the sale of alcohol. These sales are slightly different from the sale of alcohol at recreational clubs. SARS allows recreational clubs a dispensation in respect of alcohol sold to members and their guests. This is not available to major stadia, where alcohol is sold to members because these sales fall under a trading activity at the stadia.

A similar situation is applicable with respect to income from concession stands, which falls under the environment of trading income. Concession stands include rental received in respect of the sales of food, clothing and merchandise sold at sports shops.

#### 3.1.11. Other Commercial Income

Sports organisations are likely to be faced with other fees of a commercial nature. Some examples of these are:

1. Replica clothing: in recent years replica has become a major money-spinner. This includes player gear worn by major teams. These are sold under licences either by the event licence holder of the sports body or the manufacturer.
2. Sponsors names are prominently displayed, as are the team sponsors and manufacturers. This is a trading activity that is fully taxable.
3. Digital content:
  - This area is a major source of revenue and identified as a flow of income to be received by sports organisations in the forthcoming



years.<sup>35</sup> With the explosion of digital platforms such as the Internet, Twitter and Facebook, content has become king and now distributed worldwide in real-time.

- Sports bodies now trademark the content and transmission of data as a valuable source of income. This is another trading activity that is fully taxable.

### 3.1.12. Appearance Money

During the course of a season, sports organisations may engage with overseas professionals. Sports bodies need to be aware of the taxes applicable to international sports persons, particularly section 47A and 47B of the Income Tax Act.

Sports organisations must also consider whether the employee is a resident of South Africa. This usually is the case if the player is ordinarily resident in South Africa or physically present for more than 183 days. If a player is a resident in South Africa for more than 183 days, the player will be taxed as an employee.

Sports organisations are referred to section 47A and section 47B of the Income Tax Act for the implications for the recipient of prize money, where tax may be withheld.

The taxation of sportspersons is not dealt with further in this dissertation except for mentioning guest appearances (below) for completeness sake.

### 3.1.13. Guest Appearances

From time to time, sports organisations engage international and local sports people for their services as motivational speakers and coaches. Here, section 47A and section 47B in respect of international persons and the Fourth Schedule of the Income Tax Act (which deals specifically with employment income) in respect of residents is applicable.

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<sup>35</sup> Ibid at Chapter 6.

## 3.2. Revenue for Recreational Clubs

Recreational clubs are defined as clubs where activity is "organized for pleasure, recreation, and other non-profitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inuring to the benefit of any private shareholder."<sup>36</sup>

Recreational clubs receive, in the main, similar revenue streams as discussed above. Section 30A of the ITA sets out the basis of the taxation of revenue as it applies to recreational clubs. In order to be tax-free, the income must be received or accrued with the provision of providing social and recreational facilities for its members.

### 3.2.1. Bar Income

Many recreational sports clubs run a bar and entertainment facilities for both its members and non-members. Due to the complexity in separating transactions for members and non-members, SARS allows for the full income from this source to be regarded as tax-free income.<sup>37</sup>

However, it is worth noting that where facilities are outsourced, the income received will be categorised as rental income and be fully taxed.<sup>38</sup>

### 3.2.2. Hire of Equipment

In the event that hiring of equipment is closely linked to the provision of social or recreational facilities to the members, the income will be tax-free. An example of this is the hiring of golf trolleys to members of a golf club.<sup>39</sup>

### 3.2.3. Subscriptions

Clubs in general have an annual subscription fee for membership of the club.

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<sup>36</sup> Internal Revenue Manual - 7.25.7 Social and Recreational Clubs", *Irs.Gov*, accessed August 7, 2016, [https://www.irs.gov/irm/part7/irm\\_07-025-007.html](https://www.irs.gov/irm/part7/irm_07-025-007.html).

<sup>37</sup> Section 10(1)(cO)(ii) of Income Tax Act.

<sup>38</sup> South African Revenue Services. *Tax Guide for Recreational Clubs (Issue 2)*. Pretoria: SARS, 2013.

P 16 Example 11Facts (2).

<sup>39</sup> *Ibid* 38.

This income will be tax-free.<sup>40</sup>

### 3.2.4. Advertising

Sports clubs often succeed in selling advertising to local businesses. As this is a transaction that is not related to the provision of recreational or social activities for members; it is entirely taxable.

### 3.2.5. Rental Income

A number of clubs lease additional facilities to businesses. Facilities that are leased include gym, sporting merchandise shops, and car wash facilities. This is taxable as it does not relate to the provision of sporting or recreational facilities for members.

### 3.2.6. Sponsorship Income

Clubs receive sponsorship income in all probability from local businesses. Recreational clubs need to strategically structure sponsorship deals. If it is a cash deal it is likely to attract tax. If the form of payment stipulated in the contract is in kind, for example equipment to be used in the provision of facilities for members, the income received will be tax-free.

### 3.2.7. Lotto Income

Several clubs receive income from the National Lottery. The income will be tax-free as long as it relates to the provision of facilities for members.

### 3.2.8. Barter Income

Barter exchange<sup>41</sup> is an important source of revenue. This needs to be accounted for correctly by recreational clubs and if the exchange is used to provide recreational facilities for members, it will be tax-free.

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<sup>40</sup> Section 10(1)(cO)(1) of Income Tax Act.

<sup>41</sup> *South Atlantic Jazz Festival (Pty) Ltd v CSARS* (Case No: A 129/2014, dated 6 February 2015).

### 3.2.9. Other Income

Additional income streams include the rental of property space. An example of this is the rental of property to host cell phone masts and car washes. Since these do not relate to the provision of services to members, these will be subject to income tax.

### 3.2.10. Outsourced Facilities

Facilities that are sublet will be subject to taxation because these do not relate to the provision of services to members.

## CHAPTER 4

### THE CONCEPT OF A PBO

Following the recommendations from the Katz Commission's Ninth Interim Report, legislation was introduced to regulate the taxation of PBOs in South Africa.

The Katz Commission recommended that all non-profit organisations (NPO's) be grouped under one section in the ITA. In 2000 the Minister of Finance introduced to Parliament legislation that would regulate all NPOs and sporting bodies<sup>42</sup> which were to be included under this umbrella of Public Benefit Organisations (PBO's).

Section 30 of the ITA was introduced and sets out the conditions under which a PBO can operate and function.

For a sports organisation to be approved as a PBO, it must be constituted in one of the following ways:

- A non-profit company incorporated in South Africa.
- A trust established in South Africa.
- An association of persons formed or established in South Africa.
- A branch established in South Africa by a foreign organisation that is incorporated, formed or established in a country outside South Africa and which is itself exempt from income tax in that other country.

Section 10(1) (cN) further sets out how receipts and accruals of a PBO will be exempt from tax.

#### 4.1 Public Benefit Organisations and the Legislation

This part analyses the tax legislation in relation to PBOs.

In order to qualify as a PBO, the organisation must carry on a Public Benefit Activity (PBA).<sup>43</sup> PBAs are defined in Part 1 of the Ninth Schedule.<sup>44</sup> The

<sup>42</sup> Manuel, T.A. "Budget Speech 2007" (speech, Annual National Budget Speech, Department: National Treasury, Cape Town, February 21, 2007). P 20.

<sup>43</sup> Section 30(1) of the Income Tax Act.

<sup>44</sup> Ninth Schedule of the Income Tax Act.

minister of finance may also from time to time determine the criteria of a PBA.

A Public Benefit Organisation is defined in section 30 (1) (a). It can be a non-profit company as defined in S1 of the Companies Act, a trust or an association of persons incorporated, formed or established in South Africa.

From the abovementioned, it is clear that any three of the above corporate structures will suffice when applying for PBO status; therefore, it is not necessary to form a company. Most sporting bodies in South Africa are generally an association of persons.

Paragraph (a)(ii) of the definition of 'public benefit organisation' governs the situation where any branch of a foreign company, trust or association can qualify as a PBO in South Africa.

Four conditions are imposed, in terms of paragraph (b) of the definition of public benefit organisation, for qualification as a PBO. Most importantly, a structure's main purpose must be to carry on one or more PBAs in order to qualify as a PBO.<sup>45</sup> The PBA must be managed in a non-profit manner and be of an altruistic or philanthropic nature. This means that sporting bodies conducting a business activity or the like may not qualify as a PBO.<sup>46</sup>

A further condition imposed by paragraph(b)(ii) of the same definition is that the PBA must not support the self-interest, directly or indirectly, of any individual and remuneration paid must be reasonable.

This condition was included to prevent abuse as demonstrated by the case of the former Financial Manager of the Sharks Rugby franchise. She was dismissed for abusing the system by writing off personal expenditure and claiming value added tax (VAT) on personal expenditure. The matter was reported to SARS.<sup>47</sup>

Organisations must be cautious by ensuring that remuneration of employees

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<sup>45</sup> Section 30(1) of the Income Tax Act.

<sup>46</sup> Section 30(1)(b) of the Income Tax Act.

<sup>47</sup> IOL, "Sharks keep their head above water" 2004.

is market related; otherwise the PBO may risk losing its status.<sup>48</sup>

Paragraph(c)(1) of the definition regulates that the PBO membership must be available to the general public and not a closed grouping.

The exemption of receipts and accruals for a PBO is set out in section 10(cN) of the ITA. Section 10(cN)(1) states that any receipt or accrual, otherwise from a business or trading activity, is exempt from income taxation. Amateur sport qualifies as a PBA. Accordingly, where sporting organisations participate entirely in amateur sport, receipts and accruals will not be subject to tax. It is clear that when donations are received, these will be entirely tax-free. Likewise, where sponsorship income is received, for as long as the income is used for amateur sport, it will be tax-free.

Many national and provincial sporting bodies administer both an amateur and professional sport.<sup>49</sup> Such bodies may choose to (a) split the organisation in two parts, one amateur and one professional, or (b) opt out of being a PBO altogether and operate as a normal company or organisation. SARS amended the Income Tax Act thereby allowing the deduction of development expenditure and promotion of amateur sport against taxable receipts (section 11E) in these companies which do not have exempt status. These sporting organisations will be taxed in terms of the standard tax rules applicable to companies.

However, where national and provincial sporting bodies only conduct amateur sport, they will qualify for PBO status.<sup>50</sup> In the case where a national or provincial sporting body administers both amateur and professional sport, it may then opt to register a PBO and a company; however, this is a cumbersome process from all practical points of view.

Section 10(cN) exempts the receipts and accruals of any PBO approved by SARS in terms of S30(3), to the extent that receipts or accruals satisfy the

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<sup>48</sup> Paragraph(b)(ii), definition 'public benefit organization'.

<sup>49</sup> South African Revenue Services, *Tax Exemption Guide for Public Benefit Organisations in South Africa*, (Pretoria: SARS, 2014), <http://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-Gen-G03%20-%20Tax%20Exemption%20Guide%20for%20Public%20Benefit%20Organisations%20in%20South%20Africa%20-%20External%20Guide.pdf>. P 18.

<sup>50</sup> Ninth Schedule of the Income Tax Act -Public Benefit Activity Para 9.

definition below:

- (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.*

The Income Tax Act does not define a business activity or a trading activity; however it does define trade,<sup>51</sup> which is discussed in section 4.2.1.

When sporting bodies opt to apply for PBO status, certain income and accruals may be exempt from income taxation as long as the business activity is directly related to the main object of the PBO (section 10(cN)(ii)(aa)(A)). The guide issued by SARS gives clear examples of this.

This is best illustrated using a practical example. SARS granted SASCOG approval with PBO status. SASCOG disclosed income from trade-offs with South African Airways,<sup>52</sup> which is clearly a business deal. However, SASCOG used the trade-off to fly athletes to competitions. But, if SASCOG paid athletes on a professional basis and received sponsorship for this purpose, it could no longer qualify for a PBO status.

There are further conditions that must be complied with in order for the income and expenses to be tax-exempt, although these relate to a business activity. These conditions are clearly set out in section 10(cN) and stated

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<sup>51</sup> Section 1, definition of trade of the Income Tax Act.

<sup>52</sup> South African Sports Confederation and Olympic Committee, *Annual Report 2011 - 2012*, (Johannesburg: SASCOG, 2012), [www.wp-sports-council.org.za/getattachment/16523801-b838-4d9e-84a6-3ddf030c5bee/SASCOG-2012.aspx](http://www.wp-sports-council.org.za/getattachment/16523801-b838-4d9e-84a6-3ddf030c5bee/SASCOG-2012.aspx). P 65.



above.

The basis on which the profit is calculated on the business activity must incorporate costs associated with running the PBO. The Act stipulates that the profit “is carried out or conducted on a basis substantially the whole of which is directed towards the recovery of cost.”<sup>53</sup> The PBO should allocate costs of the PBO to the business activity rather than using some arbitrary mark-up, which has a clear profit motive.

Costs are not defined and each case must be looked at based on its own merits. However, costs related to the running of the PBO must be reasonable and not excessive.<sup>54</sup> The costs must be applied to the income of the business activity directly or indirectly. SARS has accepted that the ratio of costs to the income cannot be less than 90%, although for practical purposes, SARS will accept a threshold of 85%.<sup>55</sup> As a result, costs cannot account for less than 85% of the income of the business activity.

A further requirement is that the undertaking or activity does not result in unfair competition to other businesses or taxable entities.<sup>56</sup> This is best illustrated by an example. A sports club running a bar cannot run this activity in competition to bars in the area or within close proximity of the club.

If the sporting body does conduct an activity that competes with other undertakings, it could lose its tax-exempt status.

Finally, the undertaking or activity must be of an occasional nature and undertaken on a voluntary basis without compensation.<sup>57</sup> This obviously refers to fund raising activities.

The minister of finance *may* approve a body as a business undertaking or a trading activity as set out in section 10(cN)(cc) of the ITA.

*(cc) if the undertaking or activity is approved by the Minister by notice in*

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<sup>53</sup> Section 10(cN)(ii)(aa)(B) of the Income Tax Act.

<sup>54</sup> South African Revenue Services, "Tax Exemption guide for Public Benefit Organisations in South Africa".

<sup>55</sup> *Ibid.* P 12.

<sup>56</sup> Section 10(cN)(ii)(aa)(C) of the Income Tax Act.

<sup>57</sup> Section 10(cN)(ii)(bb) of the Income Tax Act.

*the Gazette, with 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.*

## 4.2 Amalgamation of Amateur and Professional Sport

A new chapter for the income taxation of sporting bodies was heralded in 2001. Like all PBOs, sporting bodies could only register as a PBO if the main purpose was to conduct amateur sport activities. Most major national and amateur provincial sporting bodies engage in both professional and amateur sports activities. Should multipurpose sporting bodies use the professional arm to finance the amateur arm? In South Africa, the development of sport is given some level of priority which is demonstrated by the inclusion in the ITA of section 11E of the ITA, which allows for the deduction of development and promotion expenses.

The introduction of the PBO legislation in 2001 meant that sporting bodies had to reorganise their affairs. In 2001 PBOs could not be involved in any business activity, let alone a limited business activity. This was amended in 2006, when limited business activities were allowed, as set out above.

This resulted in the introduction of legislation in 2001 which forced national and provincial sporting bodies to separate these two operations. The reason for doing so was mainly due to quasi-professional sporting bodies being prohibited from deducting development expenditure in terms of the then provisions of the ITA and in terms of case law. As a result, sporting bodies were obliged to separate amateur operations from professional operations in

order to qualify for tax-exempt status of operations. This became cumbersome and time consuming for the sporting bodies to administer. Consequently, in 2007 the Minister announced during the Budget Review that certain changes would come into effect.

These changes resulted in the re-integration of separate sporting bodies, thereby allowing these to operate as a single entity. SARS issued a practice note setting out how the merger was to take place.<sup>58</sup> This had to be done in terms of section 125 of the ITA, which was deemed to come into effect on 1 January 2008. Therefore, merger transactions, under section 125, had to be concluded by December 2012. The amalgamated sporting bodies, if they complied with certain requirements, could arrange for one body to dispose of its assets to the other body, on a tax neutral basis. This in essence, meant that the sporting body could operate as one entity. In order to facilitate the change, sport bodies could no longer operate as PBOs since they would lose their tax-exempt status.

Therefore, in order to facilitate the operations of an amalgamated sporting body, SARS had to make certain amendments to the ITA in order to accommodate the tax deductibility of certain expenses incurred. Under normal circumstances, these expenses would not qualify as a deduction in terms of section 11(a) (general deduction formula) and section 23(g) (no deduction for non-trade expenditure) of the ITA.

The adjustments made to the ITA to accommodate changes in the way sporting bodies could *operate* are discussed below.

Section 1 of the definition of gross income in the ITA was amended with the addition of paragraph (IA). This paragraph reads as follows:

*'Any amount received by or accrued to a company or association as contemplated in subparagraph (ii) of section 11E;'* this refers to a sporting body receiving money from a mother body for development or promotion

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<sup>58</sup> South African Revenue Services, *Interpretation Note: NO. 46 (Issue 4)*, (Pretoria: SARS, 2012), <http://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-46-Arc-82%20-%20IN46%20Issue%204%20Archived%20on%2022%20June%202015.pdf>.

which must be included in gross income.

The following example shows this clearly. CSA distributes money to its provincial affiliates. In turn, these affiliates distribute money to affiliated recreational clubs. This money must be disclosed as income in both the provincial affiliate's hands and that of the recreation club.

As far as expenses are concerned, two provisions, section 11E and section 24E were added to the ITA. Section 11E of the ITA reads as follows:

Deduction of certain expenditure incurred by sporting bodies.

*'For the purposes of determining the taxable income derived by:*

*(a) any non-profit company as defined in the Companies Act; or*

*(b) an association of persons that has been incorporated, formed or established in the Republic, from carrying on sporting activities falling under a code of sport administered and controlled by a national federation as contemplated in section 1 of the National Sport and Recreation Act, 1998(Act No. 110 of 1998), there shall be allowed as a deduction from income of that company or association:*

*(i) expenditure not of a capital nature, incurred by that company or association on development and promotion, directly by that company or association; or*

*(ii) any payment made to any other company or association contemplated in this Section for expenditure to be incurred on development and promotion, of sporting activities contemplated in paragraph 9 of Part 1 of the Ninth Schedule falling under that code of sport.'*

In terms of section 11E, sporting bodies were allowed to deduct development and promotion expenses in cases where they were no longer registered as a PBO. As a registered PBO, a sporting body is allowed to deduct all expenditure in respect of "*administration, development, coordination or promotion of sport or recreation in which the participants take part on a non-*

*professional basis as a pastime.*<sup>59</sup>

Section 11E was introduced into the ITA in 2007 to allow sporting bodies to deduct expenditure in respect of development expenditure and expenditure in respect of promotion of development of the sport.

As pointed out, section 11E allows sporting bodies to deduct expenditure that would not ordinarily be deducted under section 11(a) (general deductions). SARS recognises that sporting bodies play a significant role in the development of sport in South Africa. Sport bodies opting to be taxed as a single entity would be taxed as a normal corporate and be obligated to comply with standard taxation administration laws. They are required to submit full tax returns as well as comply with submitting provisional tax returns.

Sporting bodies opting to be taxed under section 11E will be required to take careful note of the implications of section 11E. There are two parts to the section:

- i. Part 1 of section 11E allows only for the deduction of expenditure of a non-capital nature by that company or association on development or promotion. This means that sporting bodies subject to this section can no longer spend money on capital expenditure for development and promotion, as had been the case if such a company or association is an approved PBO. This is best illustrated by a practical example.

Cricket South Africa NPC can no longer claim a tax deduction for erecting capital assets such as clubhouses as part of its development program. CSA acknowledged this fact in the taxation note in its annual financial statements.<sup>60</sup> CSA can still fund such projects directly or indirectly. However, the tax deduction is prohibited by section 11E of the ITA. It can however allocate money for the building of capital assets to a provincial

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<sup>59</sup> Ninth Schedule of the ITA – Public Benefit Activities 2002 (Paragraph 9).

<sup>60</sup> Cricket South Africa. *Annual Financial Statements*. Johannesburg: Cricket South Africa, 2014. P 18 Note 6.

or club affiliate who will be able to claim the money under section 11E. If this is indeed the case, the provincial affiliate or recreational club must declare such income received in terms of paragraph (A) of the gross income definition in their tax returns.

I will use the following example to demonstrate this. The forerunner to CSA, the United Cricket Board of South Africa (UCBSA) built several capital facilities in poor and underdeveloped areas. This included the construction of a clubhouse and oval in Soweto.<sup>61</sup> UCBSA also entered into a lucrative sponsorship agreement with building materials company, PPC, to build clubhouses and pitches throughout South Africa.<sup>62</sup>

- ii. Cricket South Africa was allowed to deduct the payment made to any other company or association for development and promotion including money disbursed for capital expenses (section 11E (b)(ii)).

Consequently, it appears that any unspent money earmarked for development and promotion at the end of the tax year will be subject to tax. There is however, a possibility of deferring income earmarked for development and promotion in terms of S24E.

Section 24E provides as follows:

Allowance in respect of future expenditure by sporting bodies:

- 1) *If income is received by or accrued to the taxpayer contemplated in S11E in respect of an event that will not reoccur in the following year of assessment, the taxpayer may for the purposes of determining taxable income deduct so much of that income as will be required to fund expenditure contemplated in section 11E that will be incurred in a*

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<sup>61</sup> "Soweto Cricket Oval, Designed by Jo Noero (Noero Architects)," Jo Noero & Noero Architects L Cape Town, South Africa, accessed February 11, 2016, <http://www.noeroarchitects.com/soweto-cricket-oval/>.

<sup>62</sup> Tomes, R. "Creating Shareholder Value: A Case Study of the PPC Brand," (master's thesis, University of Stellenbosch, 2011).

*future year of assessment.*

- 2) *Any amount allowed to be deducted in terms of subsection (1) in any year of assessment must be deemed to be income received by or accrued to the taxpayer in the following year of assessment.*

As a result, the limitation of amalgamating the amateur and professional bodies is that monies received for development expenditure, which remains unspent at the end of the year, will also be taxed, albeit subject to the application of section 24E. Development and promotion income received or accrued by a sporting body and not spent at the end of the financial year, will be subject to tax along with taxable income from professional sport. This is in contrast to a PBO, which will not be subject to tax in terms of paragraph 9 of the Ninth Schedule Part 1.

This means that being exempt from tax is not applicable to sporting bodies that opt for the amalgamated option. They will, however, be allowed to set-off any taxable income against any assessed loss brought forward. It is of further concern that the amalgamated bodies will not automatically receive exemption from income tax on genuine amateur transactions as the amalgamated body has lost its tax-exempt status after opting to amalgamate the amateur and professional body. This is clearly stated in the summary of the legislation (section 30 of the ITA) which is applicable to merged sporting bodies as set out in the Interpretation Note 46.<sup>63</sup>

Sporting bodies will be required to follow International Financial Reporting Standards (IFRS) when disclosing tax.<sup>64</sup>

Before proceeding with a detailed analysis of section 11E and section 24E, it is necessary to discuss key principles that influence the taxation of sporting bodies.

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<sup>63</sup> South African Revenue Services, "Interpretation Note No 46 (Issue 4)".

<sup>64</sup> Moore Stephens Cape Town Inc., *Western Province Cricket Club Annual Financial Statements for the year ended 31 May 2015*, (Cape Town: Western Province Cricket Club, 2015), accessed October 30, 2015.

#### 4.2.1 Business Undertaking or Trading Activity for a PBO

In order to qualify as a PBO, a sporting body may engage in limited business activities.. Initially, no trading activity was allowed but this restraint was relaxed in 2006. The ITA does not define business undertaking or trading activity but does have a definition of trade. “*Trade includes every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of or the grant of permission to use any patent as defined in the Patents Act or any design as defined in the Designs Act or any trade mark as defined in the Trade Marks Act or any copyright as defined in the Copyright Act or any other property which is of a similar nature*”.<sup>65</sup>

The definition of trade has been the subject of a number of court decisions. As Williams indicated in *Income Tax in South Africa Cases & Materials Third Edition*<sup>66</sup> “a significant gloss was put on the principle by the majority judgment of the Appellate Division in *CIR v Pick n Pay Employee Share Purchase Scheme*”.<sup>67</sup> The court ruled that a distinction had to be drawn between carrying on a business and a profit-making scheme. Once trade constitutes a profit-making scheme, the receipts will be regarded as income and be subject to income tax.

PBOs receive some leeway in this regard. As long as the scheme of profit-making is “integral and directly related to the sole or principal object of the PBO, such income will be free from income tax”.<sup>68</sup>

This is best illustrated by an example. A charity providing accommodation for the homeless may rent out unused accommodation to generate some income. A cafeteria of a school will have its receipts free from income tax. This is because the scheme of profit-making is “integral and directly related to the sole or principal object of the school and as such, the income will be free from income tax.”

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<sup>65</sup> Section 1 of the Income Tax Act.

<sup>66</sup> Williams, R.C. *Income Tax in South Africa: Cases & Materials* (Durban: LexisNexis, 2009), P 245.

<sup>67</sup> *Pick n Pay Employee Share Purchase Trust, CIR v 1992 (4) SA 39 (A) 54 SATC 271.*

<sup>68</sup> Section 10(cN)(ii)(aa)(A) of the Income Tax Act.



#### 4.2.2 What is the Effect of Trade on a Recreational Club?

Section 30B sets out the conditions for approval of a recreational club while Section 10(1)(cO) sets out the rules for exemption of income and accruals for a recreational club.

The basic exemption from income taxation for recreational clubs is membership fees.<sup>69</sup> Similar wording to that of PBOs has been included for recreational clubs. All receipts and accruals will be exempt as long as they are integral to and directly related to the provision of social and recreational amenities.

#### 4.2.3 Introduction to National and Provincial Sporting Bodies

National sporting bodies are the governing organisations for sport in South Africa. Provincial sport bodies are the affiliates provincial or club affiliate. Cricket, rugby and football sporting bodies receive by far the most spectator and income support compared to any other sporting body.

Following recommendations from the Katz Commission in 2000, sports bodies were incorporated under the umbrella of Public Benefit Organisations (PBOs). In order to qualify as a PBO, the sport had to comply with the provisions of section 30. The exemption of income accrues under section 10(1)(cN) of the ITA.

At the time of the introduction of PBOs in 2000, the major sporting codes consisted of both a professional section and an amateur section merged under an association of persons. This meant that the code had to split itself into two distinct entities, one to comply with PBO legislation and the other to accommodate the professional side. This resulted in a private company being floated to accommodate the professional side and an association or union to look after the amateur section. In 2007 CSARS acknowledged this was too cumbersome and allowed the bodies to merge into one body with the amateur side no longer being eligible for PBO

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<sup>69</sup> Section 10(cO)(i) of the Income Tax Act.

status.<sup>70</sup> To compensate, section 11E together with section 24E, was introduced. This allowed for the deduction of development expenditure and the promotion of development.<sup>71</sup> The introduction of section 11E together with section 24E paved the way for sporting bodies to operate under a single body, which was not the case prior to 2000, where sporting bodies could not deduct development and promotion expenses except if it had registered as a PBO.

#### 4.2.4 Introduction of section 11E and section 24E and its Implications on Sporting Bodies

In 2006 the Minister of Finance announced the addition of two provisions to the ITA, which affected sport. This was followed by discussions with Cricket South Africa (CSA). The Minister and government acknowledged the work done in the field of development by sporting bodies. Government also acknowledged that certain sporting bodies used income and profits from professional sport to finance development. Splitting the activities of a PBO was a cumbersome process that was acknowledged by the Ministry. As a result, the Ministry agreed to sports bodies operating as one entity.

The Minister said, “Arising from discussion with Cricket SA recently, amendments are also proposed to ease the tax liabilities of professional sport bodies that contribute meaningfully to the development of amateur sports.”<sup>72</sup>

Section 11E and section 24E were added to the ITA as a consequence.<sup>73</sup> These sections are proving difficult to interpret from my initial discussions with CSA.

It is important to consider the intention of the Minister when trying to interpret section 11E and section 24E. Before discussing and analysing section 11E and section 24E, it is necessary to consider the interpretation of fiscal legislation and the general principles of taxation in South Africa.

### 4.3 Interpretation of Fiscal Legislation in South Africa

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<sup>70</sup> Manuel, Budget Speech 2007. P 24.

<sup>71</sup> Ibid.

<sup>72</sup> Manuel, Budget Speech 2007. P 24.

<sup>73</sup> S11E and S24E Income Tax Act.

### 4.3.1 Basic South African Taxation Concepts

It is widely accepted that when analysing fiscal legislation, one must consider the special rules in this regard. The courts have given guidance in this regard.

After a succession of legal cases including appeals, the Supreme Court of Appeal settled for a version in “the Pension Fund” case.<sup>74</sup>

The judge set out the basic test as follows: South African courts will generally interpret legislation by examining the words used in context within the provisions and the Act. Where the meaning of the words is clear, the meaning will be adopted.

“Where the intention of Parliament is clear, but the words do not properly convey such intention, the courts will interpret the words used according to the intention of Parliament. However, if the intention of the lawmakers is unclear, the ordinary meaning of the words and the context in which they are used will determine the intention of Parliament. In cases where the words used provide two equivalent meanings, the *contra fiscum* principle must be applied, that is, the ambiguous provision must be interpreted in favour of the taxpayer.”<sup>75</sup>

### 4.3.2 General Principles of Taxation in South Africa

SARS levies tax on a taxpayer’s net income, which is gross income (other than exempt income), less allowable deductions. It is appropriate to analyse the definition of gross income as this affects both residents and non-residents of South Africa. Section 1 of the ITA defines gross income as follows:

*‘In relation to any year or period of assessment, means:*

- (i) In the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; or*
- (ii) In the case of any person other than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within the Republic.*

<sup>74</sup> *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 903 (SCA).

<sup>75</sup> *Ibid.*

(iii) *During such year or period of assessment, excluding receipts or accruals of a capital nature.'*

I deal with only aspects of the gross income (GI) definition that affect sporting organisations. The definition then goes on to list certain specific inclusions. Paragraph (IA) requires a sporting body (contemplated in section 11E) to include income received from another sporting body in its gross income.

In the case of resident sporting organisations, all income received or accrued in cash or otherwise will be subject to tax in South Africa. The same principle applies to the income received by a non-resident sporting organisation from a South African source.

This is particularly relevant as resident sporting bodies compete on a worldwide basis and income earned or received is taxable in full in South Africa. This still applies, even if the income is set off against some other matter or diverted by donation as is the case in the FIFA World Cup Legacy Trust.<sup>76 77</sup>

The Legacy Trust was created by FIFA after a meeting between then FIFA President Joseph S Blatter and South African President Jacob Zuma in Johannesburg, South Africa on 13 December 2010. "This trust will support a wide range of public benefit initiatives in the areas of football development, education, health and humanitarian activities in South Africa. The trust forms part of FIFA's 2010 FIFA World Cup™-related legacy programmes and delivers on FIFA's pledge to ensure that South Africans will continue to benefit from the 2010 FIFA World Cup™".

The trust fund amounted to USD 100 million, of which USD 80 million is being allocated directly to social community projects. The remaining USD 20 million

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<sup>76</sup> South African Football Association, "2010 FIFA World Cup Legacy Trust," SAFA, accessed May 19, 2015, <http://2010legacytrust.com/cms/>.

<sup>77</sup> FIFA.com, *FIFA Launches 2010 FIFA World Cup Legacy Trust for South Africa*, 2010, accessed January 17, 2016, <http://www.fifa.com/worldcup/news/y=2010/m=12/news=fifa-launches-2010-fifa-world-cup-legacy-trust-for-south-africa-1350917.html>.

was already provided to the South African Football Association (SAFA) in the build-up to the event in the preparation and construction of SAFA House.”

The beneficiaries will be selected for social community projects within the following four areas:

- Football: administration, development, coordination or promotion of non-professional football.
- Education and development: provision of education by a school as defined in the South African Schools Act.
- Health care: provision of health care services to disadvantaged communities, including prevention of HIV infection and other preventative and education programmes.
- Humanitarian activities: community development for disadvantaged persons and anti-poverty initiatives.

It is clear from the above that the money for football development was not restricted for use in South Africa. Money was donated to the Caribbean Football Association as well. Given South Africa’s tax legislation, the money donated must be included in the gross income of SAFA. The amount in question was USD 10 million for coaching in the Caribbean. The South African Football Association should disclose this money as income; notwithstanding that SAFA is a PBO in terms of the gross income definition.<sup>78</sup>

As mentioned above a sporting body must include in its GI income received in terms of section 11E from another sporting body. It is thus imperative to analyse S11E. S11E deals specifically with the payment by a sporting body in respect of development and promotion of certain qualifying amateur sport to another sports body.

#### 4.3.3 An analysis of section 11E

Section 11E deals with the deduction of expenditure that is incurred by sporting bodies. A full definition is recorded in 4.2 above.

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<sup>78</sup> Brümmer, S. et al., "Danny Jordaan's Damning Letter To Fifa", *Mail & Guardian*, 2015, accessed February 26, 2016, <http://mg.co.za/article/2015-06-04-danny-jordaans-damning-letter-to-fifa>.

This section allows companies and associations to deduct development and promotion expenses. This is explored in detail below. A closer analysis of the section clearly indicates that expenditure must be made by either a non-profit company (NPC) or a non-profit association conducting sporting activities under a national federation as contemplated in section 1 of the National Sport and Recreation Act, 1988.<sup>79</sup>

Expenditure must not be of a capital nature and be used directly in the development or promotion of sport, directly by that NPC or association or by any other company or association on expenditure for development and promotion.

It is clear that the allowance is in respect of a non-profit company or association of persons that is incorporated, formed or established in the Republic. Further, it must conduct sporting activities as defined in section 1 of the National Sporting and Recreation Act of 1988.<sup>80</sup>

Section 11E states that the money must be utilised for the development and promotion of sport. Neither term has been defined in the Income Tax Act. Court judgments have indicated that tax terms not defined must be given their normal interpretation.

Development has been the main criteria for the unification of sport in South Africa. Sport development generally refers to the provision of facilities and coaching of South Africa's poor, under privileged or historically disadvantaged sports men and women.<sup>81</sup>

The Act states that expenditure must be of a non-capital nature in section 11E(b)(i).

Development refers to expenditure of a revenue nature. Paying for the

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<sup>79</sup> Office of the President Government Gazette, *Act No. 110, 1998 NATIONAL SPORT AND RECREATION ACT, 1998*, (Cape Town: Government Printing Works, 1998), [https://www.capetown.gov.za/en/SportRecreation/Documents/SA\\_sports\\_commission\\_act\\_110\\_1998.pdf](https://www.capetown.gov.za/en/SportRecreation/Documents/SA_sports_commission_act_110_1998.pdf).

<sup>80</sup> Ibid.

<sup>81</sup> Western Cape Department of Cultural Affairs and Sport. National Sport and Recreation Plan. Cape Town, 2012.

erection of sporting facilities, which falls within the ambit of development, will be regarded as capital expenditure.

However, most sports fields are leased from the local authorities or city councils. Expenditure on leased fields will be regarded as improvement to leased premises and can be written off against gross income. Clearly, federations will be required to plan for sponsorship received and determine budget allocations as part of this plan. Previously, sporting bodies acquired or erected capital assets as part of their contribution to development. For example, the United Cricket Board of South Africa built a cricket oval and clubhouse in Soweto<sup>82</sup> and received a lucrative sponsorship from PPC Cement for the erection of clubhouses and cricket ovals in South Africa.<sup>83</sup> Failure to plan properly will result in expenditure of a capital nature being disallowed as a deduction from income (the sponsorship received) and a possibility that a tax liability will arise from the non-allowance of the deduction.

In his budget speech in 2007, the Honourable Minister of Finance Mr Manuel made this terse statement, "Arising from discussion with Cricket SA recently, amendments are also proposed to ease the tax liabilities of professional sport bodies that contribute meaningfully to the development of amateur sports."<sup>84</sup>

#### 4.3.4 Is section 11E Applicable to Development Expenditure outside South Africa?

Neither section 11E nor the Ninth Schedule specifically state that the activity must be confined to South Africa. S11E deals with sports organisations that have chosen the amalgamated approach. The Ninth Schedule deals only with sports bodies that have been approved as a PBO.

The Ninth Schedule states the following, "The administration, development, coordination or promotion of sport or recreation in which the participants take

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<sup>82</sup> "Soweto Cricket Oval, Designed by Jo Noero (Noero Architects)".

<sup>83</sup> Richard Tomes, "Creating Shareholder Value: A Case Study of the PPC Brand," (master's thesis, University of Stellenbosch, 2011). Accessed 14 February 2016.

<sup>84</sup> Manuel, Budget Speech 2007. P 24.

part on a non-professional basis as a past time.”<sup>85</sup> South African sports organisations often support the development of sport in other under-developed countries. A point in case is the 10 million USD donated to the Caribbean countries from the profits of the 2010 FIFA World Cup. It is clear that this is not confined to South Africa only, so expenditure incurred in countries other than South Africa will be allowed as a deduction as long as it meets the definition in the Ninth schedule.

However, it is clear that sporting bodies making the disbursements will be required to provide proof that the payments are for legitimate development activities. Failure to do so may result in the amounts being disallowed as a deduction from income.

Section 11E further states that the money can be allocated to any new sporting bodies where the money will be utilised for development. “Any payment made to any other company or association contemplated in this Section for expenditure to be waived on the development and promotion of sporting activities contemplated in paragraph 9 of Part 1 of the Ninth Schedule falling inside the code of sport.”<sup>86</sup>

It is reiterated that no reference is made in the legislation that prevents the allocation or payment being made to a non-South African sports body, as long as the money is given to a sports association that promotes amateur sport.

The question therefore is, does the onus fall on the South African sporting body to make sure that the expenditure is used for development and promotion? Clearly this is the case. A South African sporting body may provide expenditure for development and promotion as the result of hosting a major sporting event. If the South African sporting body relies on section 11E, it must make sure the expenditure is used for development and promotion.

Expenditure that is not used for development purposes will not qualify as a deduction.

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<sup>85</sup> Department: National Treasury, *Act No. 30, 2002 Taxation Laws Amendment Act, 2002*, (Cape Town: Government Printing Works, 2002).

<sup>86</sup> S11E (b)(ii) of the Income Tax Act.



#### 4.3.5 Why was the section introduced?

In the case of *Commissioner for Inland Revenue v Pick 'n Pay Wholesalers (Pty) Ltd* (1987) 49 SATC 132, Pick 'n Pay, through its charismatic Chairman Raymond Ackerman, made a donation of R500 000 to the Urban Foundation, a body located in Cape Town, to address social housing skills.

Mr Ackerman was also a trustee of the Urban Foundation. The body was headed by the late Judge Steyn, who co-incidentally, was President of the Western Province Cricket Club.

Pick 'n Pay and Mr Ackerman, accompanied by its financial director, argued that the company spent large amounts of money on advertising. This advertising was split into three categories:

- Day to day advertising of goods and services.
- Advertising related to special events.
- Indirect advertising – including space allocated as editorial space in newspapers and the like for the donation to be allowed as a deduction from income tax. The amount expended had to satisfy section 11(a) of the Income Tax Act read together with section 11(g).

Section 11(a) allows deductions to be made from taxable income derived by a person carrying on any trade if the expenditure and losses are actually incurred in the production of income, provided such expenditure and losses are not of a capital nature.<sup>87</sup>

Section 23(g), at the time of the case, prohibited a deduction where any monies claimed as a deduction from income derived from trade, to the extent to which such monies are not paid or expended for trade.

The decision in the *Pick 'n Pay*<sup>88</sup> case hinged on whether the sole object of the donation to the Urban Foundation was as a result of the acquisition of indirect advertising.

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<sup>87</sup> S11(a) of the Income Tax.

<sup>88</sup> *Commissioner for Inland Revenue v Pick 'n Pay Wholesalers (Pty) Ltd* (1987) 49 SATC 132.

In a majority judgment the court held that the expense had a dual purpose. On the one hand a philanthropic purpose and on the other hand a business purpose. In the majority judgment delivered by Nicholas AJA he said, “*In all the circumstances I am of the opinion that Pick ’n Pay did not show, on the probabilities, that in making the donation it did not have a philanthropic purpose as well as a business purpose.*”<sup>89</sup>

This clearly sets out the decision and the application of section 11(a) read with section 23(g) and outlines how the courts will interpret expenses of a philanthropic nature.

#### 4.3.6 Implications for Sporting Bodies

It is clear that if section 11E was not introduced into the ITA, sporting bodies adopting the amalgamation approach to the taxation of such a body would not be able to deduct development expenditure from income arising from professional sport.

Section 11E was added to the Income Tax Act to allow sporting bodies to deduct expenditure on income received for development and promotions.

During the hosting of major sporting events such as the football, rugby and cricket world cups and the Olympic Games, monies may be distributed to national organisations and can then be deducted from taxable income by the host

It must be noted that since the introduction of legislation in 2000 affecting PBOs, sporting bodies are taxable in terms of the Income Tax Act. All rules are laid out in the Act, so no automatic exemption of expenditure is applicable other than those legislated.

Section 11E was introduced to allow sporting bodies to deduct expenses paid out for development.

In the absence of this Section, sporting bodies would be subject to tax on amounts received for development and promotion which would in turn not be

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<sup>89</sup> Ibid.

deductible, when spent on development, based on the majority judgment in *Pick 'n Pay*.<sup>90</sup>

Money expended on development and promotion will not be regarded as expenditure incurred in the production of income and therefore required a special provision (section 11E) for it to be deductible.

#### 4.3.7 Introduction of section 24E

To compliment section 11E, section 24E was introduced in 2007. Section 24E deals only with income sporting bodies may utilise for further expenditure in the future.

Section 24E is titled, “The deduction of future expenditure by sporting bodies”. A full definition is recorded under 4.2 above.

This Section, together with section 11E, is creating confusion among sporting bodies. Section 24E and section 11E have not been tested in a court of law, therefore leaving one to look to the interpretation of fiscal legislation. The language used in Section 11E is clear, however, it is less clear in Section 24E.

#### 4.3.8 Interpretation of section 24E According to Fiscal Rules

When interpreting section 24E, it is important to consider the language used by the legislators. The Minister said that the *fiscus* has noted representations from Cricket South Africa (CSA) in this regard. Consequently, the Minister announced legislation to “reduce the liability of sporting bodies that make genuine contributions to development,”<sup>91</sup> making it clear that the emphasis is on reducing the tax liability.

#### 4.3.9 Nature of Expenditure Covered By section 24E

Literature indicates that this Section refers to the income received, which is subject to deduction by sporting bodies in section 11E.

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<sup>90</sup> *Commissioner for Inland Revenue v Pick 'n Pay Wholesalers (Pty) Ltd* (1987) 49 SATC 132.

<sup>91</sup> Manuel, Budget Speech 2007. P 24.

This is specified by the words “Contemplated in section 11E(1),” which means that the income must be received for the same purpose as that of the expenditure.

*To which event does the Section apply?*

The event is not defined in the Income Tax Act. This results in some level of confusion as it is unclear what type of event (every day or major) is referred to. Section 24E refers to an event that does not reoccur in the following year. The Oxford Dictionary defines an event as “The place where something happens, especially an organised event such as a concert, conference, or sporting competition.”<sup>92</sup>

In the present day, there are two types of events this Section can refer to. The first are major international events such as the FIFA World Cup, the IRB Rugby World Cup or the Olympic Games and the second are events that take place on a regular basis between countries and teams from countries.

#### 4.3.10 Major Event

Following the successful hosting of a major event, it is common practice for the hosting body to allocate profits for sports development.

This is paid predominantly to the hosting body as a ‘dividend’ over and above the hosting fee which is agreed on in the Host Agreement.

According to Section 24E, a major event does not reoccur in the following year. As a result, any income from a major event can be deferred to the following year in terms of section 24E.

#### 4.3.11 Event

Some tours to South Africa are more lucrative than others for the sporting body concerned. There are various reasons for this, including the fluctuation of the South African currency, as most deals are dollar or pound

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<sup>92</sup> *Oxford Dictionaries - Dictionary, Thesaurus, & Grammar* "Event - Definition of Event in English from the Oxford Dictionary," accessed February 27, 2016, <http://www.oxforddictionaries.com/definition/english/event>.

denominated. One of the major sources of income for sports bodies is income from the sale of television rights. Another major source of earnings stems from the sale of match tickets to international sports fans. For example some countries have a large following of local and overseas fans that spend vast amounts of money, which is true for England's cricket team. There are teams who have far fewer fans who spend less, for example, the Sri Lankan cricket team.

Furthermore, a cricket test series between South Africa and a different country each year is not an annually reoccurring event. The ICC sets the international test tours schedule every five years after agreement with the ICC Cricket Committee. The ICC then releases the International Future Tours Program which covers the next five years.<sup>93</sup> Generally, the tours are rotated between test playing countries with a fair distribution to all test playing countries. Teams play against each other once on average during a five year program. As a result, a test series between nations will not reoccur the following year.

When interpreting fiscal legislation, it is important to look at the wording of the Section, the circumstances which led to the legislation and the intention of the legislature.

In his 2007 budget speech,<sup>94</sup> the Minister of Finance stated that sporting bodies that genuinely spend money on development should have their tax liability reduced. Consequently, if these bodies comply, they become eligible to defer income from both major and ordinary events (the ordinary meaning of the words and the context in which they are used will determine the intention of Parliament-see 4.3.2).

#### 4.3.12 How does a Sports Body Interpret section 24E?

In a taxation note to the 2014 annual financial statements, Cricket South

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<sup>93</sup>International Cricket Council, "International Cricket - Future Tours Program - 2014 to 2019," ICC, accessed February 13, 2016, [http://icc-live.s3.amazonaws.com/cms/media/about\\_docs/547c2a4d42a86-Copy%20of%20Copy%20of%20FTP%202015%20to%202019%20as%20at%20Nov%202014.pdf](http://icc-live.s3.amazonaws.com/cms/media/about_docs/547c2a4d42a86-Copy%20of%20Copy%20of%20FTP%202015%20to%202019%20as%20at%20Nov%202014.pdf).

<sup>94</sup>Manuel. Budget Speech 2007. P 24.

Africa said the following:

- In terms of section 11E of the South African Income Tax Act (“The Act”), a special deduction is available to Cricket South Africa NPC. Cricket South Africa NPC may deduct from its normal income all qualifying expenditure, not of a capital nature, incurred by it on development and promotion of a qualifying amateur sport falling under the same code of sport as the professional sport it carries.
- In addition, in terms of section 24E of the Act, Cricket South Africa NPC “spikes” when a sports event is held in a particular financial year, Cricket South Africa may defer the excess income from the “spikes” out over the future years, so as to smooth out revenue.
- Section 24E therefore allows Cricket South Africa to deduct so much of the income which is not expected to reoccur in the following year of assessment as will be required to fund expenditure contemplated in section 11E which will be incurred in a future year of assessment.<sup>95</sup>

The South African Rugby Union has not included a similar note in its 2014 annual financial statements.

Is CSA NPC correct in their interpretation of section 24E in the above note in the Annual Financial Statements?

Is this what is meant by section 24E read with section 11E? The event referred to by CSA takes place annually and is it not a once off event like a World Cup or Olympic Games?

CSA clearly refers to “spikes” in a particular year “in terms of section 24E of the Act. In Note Five of the 2012 Annual Financial Statements CSA reported that “in addition, in terms of section 24E of the Act, Cricket South Africa NPC may lawfully move current income to the future. Where Cricket South Africa NPC receives revenue “spikes” when a sports event is held in a particular financial year and relatively low revenue in subsequent financial years, Cricket

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<sup>95</sup> Cricket South Africa. *Annual Financial Statements*. Johannesburg: Cricket South Africa, 2014. P 18 Note 6.

South Africa may defer the excess income from the “spikes” out over future years, so as to smooth out the revenue”.

It is clear from the above description; CSA refers to all its income and does not distinguish between major events.

Examination of section 24E reveals that income has to be received from an event by CSA NPC that has been specifically allocated for development and promotion.

#### 4.3.13 Do the sections Only Refer to Events in South Africa?

It must be noted that although these events are hosted in countries where the taxpayer is not a resident, the resident taxpayer may receive an allocation of revenue or profits attributable to the major event held in another country.

Assume for the sake of argument, the International Cricket Council (ICC) rewards all member nations participating in the World Cup. The CSA will be entitled to apply section 24E to such income, if the share of income is allocated by ICC for development.

It is submitted the South African taxpayer may receive a share of income from an event held in another country and successfully apply section 24E to the income received, as long as the income is ring fenced for development.

#### 4.3.14 Does section 24E Apply to a Provincial Affiliate of a National Sports Body?

Will section 24E apply to a provincial affiliate of a national body if in a given financial year a provincial body makes excessive profits from an event? As previously mentioned, in the international world of sport, income from international events can be influenced by the popularity of the touring team and sometimes by currency fluctuations. In this case will the provincial sports body be able to take advantage of section 24E resulting from the increase in income receivable?

Section 24E is not restricted to national bodies only. The Section sets two

conditions for deferral:

1. The income must accrue from an event that will not reoccur in the next year; and
2. The money must be used for development or promotion.

It is clear a provincial affiliate is not prevented from applying section 24E as long as the two conditions in Section 24E are satisfied.

I will use the following example to demonstrate this. The England cricket team will tour South Africa in 2015/2016. The team has a large supporter base, popularly known as the “Barmy Army”. These fans pay a premium for guaranteed tickets to attend the matches. Provincial unions sell tickets in United Kingdom (UK) pounds. This event will not reoccur the next year.

If income is earmarked for development, the sports body will be able to defer the income.

#### 4.3.15 Conclusion

In conclusion, SARS needs to clarify the position and effect of section 11E and section 24E.

In terms of S11E, will sports bodies be precluded from deducting monies that was spent on the construction of capital assets?

Does it only apply to major international events where the international controlling body makes distributions to national sporting bodies with the specific designation for development and promotion?

Do the sections apply to all income where spikes in income are caused by factors such as exchange rate fluctuations and where income revenue is dependent on the quantity and global standing of certain nations?

A further aspect that needs clarification is in what circumstances section 24E applies. Does it apply when a National Sporting Body makes a distribution to a provincial sports body? There is nothing in the legislation to prevent a



provincial body deferring a distribution made to it by a national sports body in terms of S24E.

If this is the case, sport will be placed in an advantageous position over any other business, and this is contrary to the recommendations of the Katz Commission's mandatory remarks and statements.<sup>96</sup> Furthermore, sports bodies need to carefully consider whether it is in their best interest to adopt the amalgamated approach or to operate with the professional body and the amateur body as separate entities. The latter results in the amateur body operating as a PBO which will be tax-exempt with respect to amateur sport and the professional body will be taxed as a normal tax entity in terms of the ITA.

#### 4.3.16 Recreational Clubs

Recreational and sports clubs are the backbone of amateur sport in South Africa. Recreational clubs are exempt from paying tax on receipts or accruals as long as certain guidelines are adhered to.

Recreational clubs missed the initial legislature changes implemented after the Ninth Report of the Katz Commission<sup>97</sup> was tabled and amendments to the ITA implemented by the Minister of Finance in 2001. This was a result of the conditions applicable to recreational clubs never being published by the Minister of Finance.

As far back as 1964, recreational clubs received partial exemption from tax. This was amended to full-scale exemption if certain conditions were met. The latter was contained in section 10(1)(cB)(i)(ee) of the ITA and was promulgated in 1974.

In terms of section 10(1)(cB)(i)(ee) all receipts and accruals on dealings with members are exempted from income tax and are transactions closely associated with membership such as the provision of meals and accommodation.

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<sup>96</sup> Ninth Interim Report of the Commission of Inquiry into certain Aspects of the Tax Structure of South Africa.

<sup>97</sup> Ibid Page 2.

To be fully exempt, recreational clubs had to comply with the following conditions:

- It could not distribute any profits or gains to any person;
- The funds had to be used solely for investment or the objects for which it had been established; and
- On dissolution, the remaining assets had to be transferred to a similar organisation.

Initially, before the approval of PBOs, partial exemption was granted in terms of the 1962 Act. All receipts and accruals on dealings with members were exempt from income tax and are transactions closely associated with membership, such as the provision of meals and accommodation; however, external transactions were taxed.

The amendments and consolidation proposed in 2000 made provision for PBOs' and the approved Public Benefit Activity. Provision was made for membership based clubs (recreational clubs) through the introduction of section 10(1)(d)(iii) and (iv), which was amended for those falling outside the scope of a PBO. The income tax exemption for the receipts and accruals of social and recreational clubs was included in section 10(1)(d)(iv)(aa) and subject to the approval of the Commissioner. A further provision was included which stipulated that the approval was subject to any regulations published by the Minister. These regulations were never published.

In 2007, section 10(1)(d)(iv)(aa) was removed and replaced by section 10(1)(cO) and section 30A was introduced to govern the taxation of recreational clubs. Section 10(1)(cO) provides for the exemption of certain receipts and accruals of approved recreational clubs and the taxation of other income falling outside the parameters of the income tax exemption. Section 30A sets out the requirements and conditions for compliance by clubs seeking the Commissioner's approval. These amendments came into operation on 1 April 2007 and were applicable to recreational clubs as from the first year of assessment, commencing on or after that date.

In order to qualify as a recreational club for income tax purposes, the club

must satisfy Section 30A;

1. Any single person or group of persons for financial benefit must not own the club.
2. All property and assets must vest in the club.
3. The corporate structure must be one of the following:
  - i. A non-profit company in terms of section 1 of the Companies Act, 2008 with a founding document in the form of a memorandum of incorporation;
  - ii. A voluntary association of persons whose founding document is a constitution; or
  - iii. A society formed by a group of persons whose founding document is a constitution.

Recreational clubs differ from PBOs in that the latter operates for the benefit of the general public while a club is formed by a group of individuals with a common purpose and operates for the benefit of members.<sup>98</sup>

#### 4.3.17 Taxation of Recreational Clubs

Clubs that do not operate for financial gain will not be taxed. Where income and costs are shared among members, the income and expenses will be free from taxation. Recreational clubs exclude the gain of individual members hence they share in the income and the costs.

Clubs often engage in trading activity, which should be taxable. If the trading activity is necessary to give credence to the sharing principle, the club will not be subject to taxation.

It is common for non-club members to attend activities at clubs and utilise trading facilities including bars and tuck shops. These activities are tax-exempt as it may be too complex to separate member activity from non-member activity as long as these activities are taken into account under the

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<sup>98</sup> South African Revenue Services, *TAX Guide for Recreational Clubs (Issue 2)*, (Pretoria: SARS, 2013), [https://jutalaw.co.za/media/filestore/2014/03/11\\_Dec\\_2013\\_-\\_Tax\\_Guide\\_for\\_Recreational\\_Clubs\\_-\\_External\\_Guide\\_1.pdf](https://jutalaw.co.za/media/filestore/2014/03/11_Dec_2013_-_Tax_Guide_for_Recreational_Clubs_-_External_Guide_1.pdf)). P 5.

member sharing principle.

A recreational club must apply for exemption under section 10(1)(cO). The recreational club must have a written constitution, with the sole or principal objective of providing social or recreational facilities for its members.<sup>99</sup>

All facilities must be predominantly used for social or recreational purposes. The club cannot earn most of its income from business activities.<sup>100</sup>

The club must have a formal membership structure, not a temporary or semi-formal structure. Neither is it acceptable to have day-membership only. Annual or seasonal membership is permissible.<sup>101</sup>

The club must have formal officials. There must be at least three independent and unconnected officials who take primary responsibility for the fiduciary aspects of the club. Close relatives are not acceptable.<sup>102</sup>

All clubs must have a non-profit motive based on cost recovery. Clubs cannot run on a profit basis and be in competition with businesses close by. At least 85% of the clubs income must be on the cost recovery basis.<sup>103</sup>

Funds must be solely applied to the activities of the club. Loans of a private nature are not permitted. Salaries must be commensurate with the job.<sup>104</sup>

Upon dissolution funds,<sup>105</sup> must only be distributed to the following:

1. Another recreational club approved by the Commissioner.
2. A PBO approved by the Commissioner.
3. Any institution, board or body exempt from tax under section 10(1)(cA)(i) which has, as its sole purpose or principal objective, carrying on of any PBA or
4. The government of the Republic in the national, provincial or local

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<sup>99</sup> Section 30A 1.

<sup>100</sup> Ibid 100.

<sup>101</sup> Section 30A 2(a)(v).

<sup>102</sup> Section 30A 2(a)(i) of the Income Tax Act.

<sup>103</sup> South African Revenue Services, *Binding General Ruling (Income Tax): NO. 20 (Issue 2)*, (Pretoria: SARS, 2016), <http://www.sars.gov.za/AllDocs/LegalDoclib/Rulings/LAPD-IntR-R-BGR-2013-09%20-%20BGR20%20Interpretation%20of%20expression%20substantially%20the%20whole.pdf>.

<sup>104</sup> Section 30A 2 (a)(iv).

<sup>105</sup> Section 30A 2(a)(iA)(iii).

sphere.

All amendments to the constitution must be lodged immediately with the Commissioner.

Where, at the time of application, the club does not comply with the rules, it can provide a written undertaking that it will apply in the future and that the club will be administered in terms of section 30A.

Recreational clubs are prohibited from engaging in transactions that will lead to, reduce, postpone, and avoid any tax administered by the Commissioner.<sup>106</sup>

Fundraising activities are allowed but must take place on an occasional or infrequent basis and must be organised on a voluntary basis.

#### 4.3.18 Administrative Regulations Specific to PBOs

Where recreational clubs engage in taxable activities they will receive a basic exemption when calculating their taxable income of the greater of 5% of membership fees or R120 000.<sup>107</sup> Clubs that do not register for the exemption status will:

- Be taxed as a business,
- Be subject to provisional tax and will not receive the basic exemption of R120 000 per annum, and
- Submit an annual tax return even if there is no tax liability.

Any decision of the Commissioner is subject to objection and appeal.

#### 4.3.19 Other Taxes

#### 4.3.20 Introduction

Although certain exemptions from receipts and accruals are granted in the ITA, it is imperative for sporting bodies to become familiar with current tax practices with respect to all taxes administered by SARS. The section below

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<sup>106</sup> Section 30A (2)(c).

<sup>107</sup> Section 10(1)(cO)(iv).

presents the various taxes, in addition to income taxation, applicable to sporting bodies.

#### 4.3.21 Donations Tax

Sports organisations and recreational clubs often receive donations or bequests. This can be in the form of cash or kind. This is particularly true of recreational clubs.

The Income Tax Act defines a donation as a gratuitous disposal of property.<sup>108</sup> *“A bona fide donation is a gratuitous donation or gift disposed of by the donor out of liberality or generosity, whereby the donee is enriched and the donor impoverished. It is a voluntary gift which is freely given to the donee and there may be no quid pro quo, no reciprocal obligations and no personal benefit for the donor. Should the donee give any consideration at all, it is not a donation.”* Donations received by a club or a player will not be taxable because it is regarded as a capital receipt.<sup>109</sup>

Donations made to sports organisations and recreational clubs that are registered as PBOs will not attract donations tax in the hands of the donor.<sup>110</sup> However, donations made to non-PBOs will attract tax in the hand of the donor. The tax is levied at 20% of the value of the donation.

In the case of certain donations the donor will receive an income tax deduction against his gross income in the year the donation is made. This is in terms of S18A of the ITA. However, donations free of income tax are only available to PBOs that carry on an activity in terms of Part II of the Ninth Schedule. Sports Bodies are not listed in Part II of the Ninth Schedule and consequently donations made to sports organisations are taxable in the hands of the donor.<sup>111</sup>

Donations of property outside South Africa may also attract Donations Tax in

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<sup>108</sup> Ibid Section 55 of the Income Tax Act.

<sup>109</sup> South African Revenue Services, Draft Guide On the Taxation of Professional Sports Clubs and Players (Johannesburg: SARS, 2016).

<sup>110</sup> Ibid Section 56(1)(h) of the Income Tax Act.

<sup>111</sup> Income Tax Act.

South Africa.<sup>112</sup>

Nevertheless, an approved PBO envisaged in Part [(a)(i)] of the definition of a “public benefit organisation”, which provides funds or assets to another PBO or instituting board or body referred to in S18(A)(a) of the ITA will not be subject to taxation.<sup>113</sup>

#### 4.3.22 Pay As You Earn (PAYE)

In a recent judgment in the matter of *South African Reserve Bank and another v Shuttleworth and another* (CCT 194/14, CCT 199/14) [2015] 2ACC 17 (18 June 2015) Moseneke J quoted Margaret Mitchell from *Gone with the Wind* in his opening, “Death, taxes and childbirth! There’s never any convenient time for any of them.”

In order to understand the impact of PAYE on sporting bodies, one has to first look at various relevant definitions. The definitions, contained in the Fourth Schedule of the ITA, are addressed below, followed by an analysis in relation to sports bodies.

PAYE is described as “Remuneration” in paragraph 1 of the Fourth Schedule. The Schedule explains that remuneration includes salary, wages, emoluments and other amounts paid for services rendered as well as payments made for allowances.

In addition, it includes fees paid to Directors and Office Bearers and includes payments made in respect of fringe benefits. It further comprises of payments made to independent contractors or a person carrying out a trade. The definition takes into account refunds for payments made regarding expenses incurred during the normal course of employment.

“Employee” is defined as a person (other than a company) who receives remuneration. “Employees tax” is a withholding tax, which is deducted from an employee’s remuneration on a regular basis. Tax tables issued by SARS are used to calculate the deduction. The employer has to pay the tax to SARS

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<sup>112</sup> Section 54 of the Income Tax Act.

<sup>113</sup> Income Tax Act.

within 7 days of each calendar month.

The employer must register with SARS in terms of paragraph 2(1) of the Fourth Schedule to the ITA if there is tax that has to be deducted and paid over to SARS. If no tax has to be deducted, there is no need to register.

The provisions that are necessary in order to deduct tax from remuneration are set out in the Fourth Schedule to the Income Tax Act. The Schedule also clearly states that remuneration can be made in cash or kind. Therefore, benefits of a non-cash nature can also attract employee's tax.

Paragraph 2(4) of the Fourth Schedule sets out how tax must be determined. It is clear, that any remuneration paid to a sports person who falls into the definition of employee is subject to employee tax deductions. This also applies to office bearers of sports organisations, whether serving in a fulltime or part-time capacity.<sup>114</sup> Employees' tax will not apply when the expenditure is paid as a refund due for expenses incurred during duties as an office bearer-reimbursed expenditure.

A similar situation applies to players. All payments to players are regarded as remuneration and are subject to Employees' Tax. Sports organisations must adhere to the rules related to taxation of employees as set out in the Fourth Schedule to the ITA.

Sports organisations need to take cognizance of the rules related to part-time employment. Employees are regarded as part-time when they work less than 22 hours per week. This scenario is likely for a number of sports organisations. The withholding tax for part-time work is 25% of the gross amount paid, and it is advised to use SARS PAYE Tax Tables, especially if the employee receives other income.<sup>115</sup>

A number of sports organisations enter into barter transactions with commercial partners. It must be clarified as to whether there is a fringe benefit

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<sup>114</sup> South African Revenue Services, *INCOME TAX ACT, 1962 (the Act) Note NO 5(Issue 2)*, (Pretoria: SARS, 2006), <http://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-05%20-%20Employees%20tax%20directors%20private%20companies%20close%20corporations.pdf>.

<sup>115</sup> Clegg, D. & Stretch, R. *Income Tax in South Africa* (Durban: Lexis Nexis, 2010).



to the employee in a barter transaction. Sponsored motor vehicles supplied to employees of sports organisations will be subject to the normal fringe benefit tax rules.

Tickets given to employees may be subject to employees tax. According to Clegg,<sup>116</sup> this will be the case unless utilised for legitimate business entertainment. The same applies to tickets given to officials.

Several sporting organisations employ international sports persons to bolster their teams. These players are subject to employees tax in terms of section 47A and section 47B of the Income Tax Act.<sup>117</sup> If the player is not employed in South Africa for longer than 183 days a 15% withholding tax is payable in South Africa by the employee. If the player is from a country that has a Double Tax Agreement (DTA) with South Africa, the foreign player may be allowed to offset the 15% withholding of tax in his country of residence.

Interestingly, if a player is contracted for more than 183 days but plays his sport outside of South Africa for a period that reduces the number of days in South Africa below the 183 day threshold, he will be regarded as a non-resident of South Africa and taxed accordingly as a non-resident and is subject to the requirements in section 47A to section 47K.

Another interesting aspect is performance payments or bonus payments paid to local athletes who successfully perform in high profit competitions or events like the Olympic Games. These payments are subject to income tax. Employees' Tax will be deducted according to the tax tables or at 25% if it satisfies the definition of part-time employment if paid by a South African sports organisation in South Africa.

#### 4.3.23 Value Added Tax (VAT)

VAT is charged on supplies (generally sales/other income) and the taxpayer is allowed to deduct input VAT (on expenses). Certain items, mainly foodstuffs, have been excluded from VAT. These items are zero-rated for VAT purposes.

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<sup>116</sup> Clegg, D. J. M. *LexisNexis Concise Guide To Employee Taxation 2014/2015* (Durban: LexisNexis, 2015).

<sup>117</sup> Income Tax Act.

South Africa therefore has two VAT rates, one at 14% and the other at zero percent.

All businesses defined as enterprises are subject to VAT if their taxable supplies exceed R1 million in a twelve-month period (the previous eleven months and the current month).<sup>118</sup>

Enterprises are defined as an ongoing business activity. The enterprise must supply goods and services. For a transaction to fall in the VAT net, it must be considered within the course of an enterprise. Transactions which do not form part of an enterprise are excluded, for example the sale of a private property of a business owner is not part of the business of the enterprise and it is thus excluded from the VAT net.

The Act defines enterprise<sup>119</sup> as any activities carried out continuously or regularly by any person in the Republic, or partly in the Republic, and during the course of which goods or services are supplied to any other person for consideration, whether or not for profit.

1. The definition highlights several matters: activities must be ongoing – a once off sale is excluded especially if these are private. To be an enterprise, activity must be continuous or ongoing.
2. If the seller is selling regularly and sales exceed R1 million in a 12-month period, he is obliged to register the enterprise as a VAT vendor with SARS.
3. Once registered he has to account for VAT on such sales.
4. The definition also highlights that a sale can either be made inside or outside South Africa, so foreigners are not excluded from the VAT net. This means that business activity conducted outside South Africa can attract VAT. However, many supplies made outside South Africa will be zero-rated as exports are listed as qualifying for the zero-rate (Section 11(1)(a)(i) of the VAT Act).
5. The supply of the service must be made for consideration. Consideration not only includes money but is otherwise as well –

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<sup>118</sup> Section 23(1) of the Value Added Tax Act No 89 of 1991.

<sup>119</sup> Section 1 of the Value Added Tax Act No 89 of 1991.

barter transactions are included.

6. Barter transactions are valued at the open market value – that is the amount of money that would have attributed if the sale had happened on the open market. Donations and free services do not qualify as an enterprise.
7. Donations received by an association not for gain do not constitute a consideration.

The definition of an “association not for gain”<sup>120</sup> is:

A religious institution of a public character or any other society, association or organisation (whether incorporated or not) other than an educational institution, which is conducted otherwise than for the purpose of profit, to any proprietor, member or shareholder.

Furthermore, the written constitution of an organisation must specify that any organisation must be obliged, upon dissolving to transfer any remaining assets to an organisation with similar objectives or any educational institution of public character.

The definition explains that any non-profit marketing body may potentially be an association not for gain for VAT purposes.

Zero rating of certain supplies mentioned above has reference. Zero-rated supplies are listed in section 11 of the VAT Act.

*ITC 1646*<sup>121</sup> dealt with the printing of Rugby World Cup (RWC) 1995 tickets by the South African Rugby Football Union (SARFU) on behalf of the overseas organiser. The case went on appeal after the special court held that the transaction could not be zero-rated. The appeal court agreed with this ruling, but questioned whether the supply of the overseas tickets by SARFU attracted tax at all. The court held that the value of services profited by SARFU could not be the total selling price of the tickets. The court held that it was not clear if SARFU received any consideration for the printing and

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<sup>120</sup> Ibid.

<sup>121</sup> *ITC 1646* (61 SATC 37) 1997.

delivery of the tickets. As a result, SARS was ordered to review its assessment on this basis and refund the paid taxes.

In a further development in terms of Ruling 325 published on 20 September 1991,<sup>122</sup> the winnings paid by racing organisations to horse owners were zero-rated. A specific zero-rating (section 11(2)(k)) was consequently introduced to zero-rate such winnings although the application of section 72 provides the Commissioner with a discretion to zero-rate a transaction.

It is yet to be determined if the Commissioner will apply a similar ruling to South African enterprises on winnings earned overseas in international competitions like Super Rugby or IPL cricket tournaments.

#### 4.3.24 Registration as a VAT Vendor

Enterprises with a turnover greater than R1 million per annum must register for VAT.<sup>123</sup> Voluntary registration is also available to all enterprises where the turnover is less than R1 million but certain conditions apply. However, there are pitfalls which sports organisations must carefully consider.

Any person who carries on an enterprise must register, if at the end of a particular month, the total value of taxable supplies made by him exceeds R1 million. Where an abnormal or an event of temporary nature increases the turnover to over R1 million, this must be excluded. A person may also be referred to as a club, so all sports clubs where the turnover is equal to R1 million are obliged to register.

Many sport organisations receive grants from various entities including the National Lottery. This may result in the enterprise's turnover exceeding R1 million. These grants must be omitted from the turnover calculation, and will not result in compulsory registration. Due to the value of grants fluctuating on an annual basis, they will not be included in the calculation of the threshold of R1 million. These grants fall under section 23(1)(b) (iii) of the VAT Act being of a temporary nature

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<sup>122</sup>De Koker, A.P. & Kruger, D. *Value-Added Tax in South Africa* (Durban: LexisNexis Butterworths, 2002).

<sup>123</sup> Section 23(1) of the Value Added Tax Act No 89 of 1991.

Sports organisations with a turnover in excess of R500 000 per annum may apply for voluntary registration. This applies particularly to enterprises that have large capital expenditure and need to deduct input tax incurred. However, this route must be seriously considered, as the only advantage to this is claiming input tax. Enterprises with a turnover that exceeds R1 million per annum cannot avoid registration. Sports clubs are not exempt from registration and failing to register for VAT for turnover in excess of R1 million per annum could result in SARS holding the sports organisation liable for such output tax from the time the threshold is reached.

Failure to register means sports organisations can also be held liable for interest and penalties. It is an offence not to register for VAT, section 23(4)(a) of the TAA.<sup>124</sup> The TAA Act section 46<sup>125</sup> makes it clear that the owner of a club will be held personally liable for non-payment of VAT.

#### 4.3.25 Capital Gains Tax (CGT).

Many PBOs and recreational clubs own property and other assets in South Africa. A number of clubs, however, use municipal facilities and in addition may also own fixed and other assets.

Both PBOs and recreational clubs were exempt from CGT until 1 April 2006 and 1 April 2007 respectively. The reasons for this are twofold and discussed below.

#### 4.3.26 PBOs and Capital Gains Tax

In 2006 SARS lifted certain trade restrictions for PBOs. Prior to this PBOs could not trade, hence making them exempt from all income tax and CGT. Consequently, after 1 April 2006 any capital gain or loss made on the sale of assets was not to be disregarded from CGT.

However three categories of assets will still not attract CGT on disposal. The categories are:

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<sup>124</sup> The Tax Administration Act (No. 28 Of 2011).

<sup>125</sup> Ibid.

1. Non-trading assets: assets that are solely used to carry out the work of the PBO.
2. Minimal trading assets: this applies when substantially the whole of the asset in question is used for PBO activities. Although a benchmark of 90% non-business usage has been set, SARS has agreed to an acceptable level of 85%.
3. Permissible trading assets: this refers to assets that are used by the PBO for a trading activity, which qualifies for exemption under section 10(1)(cN)(ii)(aa)(bb) or (cc).<sup>126</sup>

PBOs were required to value their assets for CGT purposes on the first day of its first year of assessment after 1 April 2006. Trading assets used in normal trading activities will however be subject to CGT.

#### 4.3.27 Recreational Clubs and CGT

As previously indicated, recreational clubs were exempt from income tax until April 2007. Recreational clubs were also completely excluded from CGT in terms of paragraph 63 of the Eighth Schedule of the ITA. However, recreational clubs are now partially taxed, which also makes them liable for CGT.

A recreational club may be granted roll over relief in terms of section 30A of the ITA as long as the club has been approved in terms of section 30A. Roll over relief delays or defers the payment of CGT on assets used to carry out activities as a recreational club. The liability for CGT will arise upon the subsequent disposal of the new asset purchased to replace the asset disposed of. It is important to note that if the club does not apply for approval in terms of section 30A it will have a valuation date as of 1 October 2001 (if the asset was in existence on or before that date). Approved clubs have a valuation date after April 2007, depending on financial year-end and approval date.

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<sup>126</sup> Paragraph 63 of the Eighth Schedule of the ITA.

#### 4.4 Concluding remarks

SARS needs to clarify the position and effect of section 11E and section 24E on sports bodies adopting the amalgamated approach..

From the detailed analysis, it is clear that sporting bodies that choose the amalgamated tax approach have not been able to directly pay for the construction of capital assets. This goes against the statement made by the Minister of Finance during 2006 when he was quoted as saying “Arising from discussion with Cricket SA recently, amendments are also proposed to ease the tax liabilities of professional sport bodies that contribute meaningfully to the development of amateur sports.”<sup>127</sup>

A detailed analysis of section 24E reflects the interpretation of the section is problematic. In addition, the definition of an event needs clarification. At present, the current definition is subject to different interpretations.

Sporting bodies need to carefully consider whether it is in their best interest to adopt the amalgamated approach or preferable to operate with the professional body and amateur body being separate. It is clear that operating as the latter allows the sporting body to function as a PBO and qualify for tax exemption due to amateur sport being its primary purpose.

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<sup>127</sup> Ibid 82.

## Chapter 5

### International Best Practice

When evaluating the taxation of sporting bodies, it is important to first understand how comparable sporting nations deal with such taxation.

This research focuses on Australia and the United Kingdom, as these two countries have similar sporting codes and domestic tax conditions to South Africa.

#### 5.1 Australia

Compared to South Africa, Australia also has a wide sporting culture. Both countries participate in similar sport codes.

The Australian taxation system is outlined in a document titled “Income Tax Exemption and Sporting Clubs” published by the Australian Taxation Office.<sup>128</sup>

##### 5.1.1 Overview

According to the Guide “Non-profit organisations, including non-sporting organisations are not automatically exempted from taxation. The income tax law specifies how a sports organisation can qualify for tax exemption. If an organisation does not fall into one of these entity types, it will not qualify for the exemption”.

The guide further recognises that sport bodies have limited resources to manage their tax affairs, therefore a manual was produced to assist in simplifying the process of determining whether the sports club qualifies or not.<sup>129</sup> The guide also recognises that tax is an ongoing matter that requires annual review given that sports clubs possibly grow from year to year. It

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<sup>128</sup> Australian Taxation Office, *Guide For Office Bearers Of Non-Profit Clubs Income Tax Exemption And Sporting Clubs* (Canberra: Australian Taxation Office, 2011).

<sup>129</sup> *Ibid* at Page 2.



therefore recommends an annual review.<sup>130</sup>

Australia makes use of a self-assessment guide to determine whether sports clubs are exempt from tax.<sup>131</sup> The system also allows for a private ruling regime.<sup>132</sup>

### 5.1.2 Type of Entity

To be exempt from tax in Australia, the sporting club can be either one of the following:

- Corporation;
- Unincorporated Association;
- Trust; or
- Partnership.

### 5.1.3 Exemption from Income Tax

Australia has more than 30 types of entities, which are exempt from tax.<sup>133</sup>

The following criteria are used to determine whether a sporting club is exempt from income taxation.<sup>134</sup>

- Is a non-profit society, association or club;
- Is established for the encouragement of a game or sport;
- Is not a charity; and
- Meets at least one of the three tests.

#### *Main Purpose of the Sporting Club*

The main purpose of the club must be for the encouragement of sport, which is necessary for the club to be exempt from tax. Any other interest must be incidental to the encouragement of the game or sport.<sup>135</sup>

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<sup>130</sup> Ibid.

<sup>131</sup> Ibid at Page 3.

<sup>132</sup> Ibid at Page 3.

<sup>133</sup> Ibid at Page 3.

<sup>134</sup> Ibid at Page 4.

<sup>135</sup> Ibid at Page 4.

*Which system used to determine whether club is exempt or not?*

Australia uses a self-assessment system which states that if the sporting club complies with the terms of exemption, it does not have to lodge an income tax return.

To qualify for an income tax exemption, the sporting club must be not for profit. A non-profit sports club does not carry on trade to make a profit or gain for its individual members.

The following do not exempt a club from being non-profit:

- Benefits received by members communally as members, such as the use of club facilities; or
- Benefits received by members that are incidental to the pursuit of the clubs objectives, such as uniforms or payment of reasonable remuneration to members for services they provide to the club.

A Non-Profit Organisation can still make a profit, but this profit must be used to carry out the purposes of the organisation and must not be distributed to owners, members or other private people.

#### 5.1.4 Interpretation Rules in Australia

The Australian guide provides apt descriptions of certain key elements. For example, society, association or club, is not defined in the Australian tax law and takes the ordinary meaning of the words.

The word “game” or “sport” is not defined in tax law and takes on the conventional meaning.

Individuals are not included in the definition of society, association or club and consequently, do not qualify for this category of tax exemption.

The definition of game and sport extends to:

- Non-athletic games such as chess and bridge.
- Sports such as motor racing in which machines facilitate the competition of people.

- Non-competitive activities such as mountaineering.

The main purpose of a club is a critical consideration when assessing the taxability of clubs.

### 5.1.5 Court Rulings on the Definition of Sporting Club

Australian courts had to make several rulings as to what constitute legitimate sporting and social clubs.<sup>136</sup>

In summary, where the clubs provided for social activities rather than genuine sporting activities, the courts ruled against inclusion under sports clubs. The reasoning was that the main purpose of the club was the provision of social activities rather than sporting activities.

In the case of *North Suburban Club Inc. vs FC of T*,<sup>137</sup> the club's annual report indicated that the club's core business was poker machines.

The court ruled that the club was not exempt from tax as a sports club. It is clear that any sports club must be cautious about the type of information disclosed and to not place this in the public domain. Nevertheless, clubs must make proper and honest disclosure.

In another case of *St Mary's Rugby League Limited v FC of T*,<sup>138</sup> the court ruled against the club, given the sheer size and intensity of the social activities.

In the case of *Tarranna Lakes County Club Limited vs FC of T*,<sup>139</sup> the court concluded that although the social activities were extensive, these activities were pursued to finance the extensive sports activities.

### 5.1.6 Summary of Australian Cases

In reviewing the abovementioned Australian cases, it is evident that in order to claim a tax-exempt status, "your club's main purpose in that year must be the

<sup>136</sup> Ibid Page 3 at 11-17.

<sup>137</sup> *North Suburban Club inc v. FC of T* [1999] AATA 463;(1999) 42 ATR 1111; 99 ATC 2254 (28 June 1999) (North Suburban).

<sup>138</sup> *St Mary's Rugby League Club Limited v. FC of T* 97 ATC 4528;(1997) 36 ATR 281 (St Mary's).

<sup>139</sup> *Terranora Lakes Country Club Limited v. FC of T* 93 ATC 4078;(1993) 25 ATR 294 (Tarranora).

encouragement of a game or sport.”<sup>140</sup>

### 5.1.7 The United Kingdom

The United Kingdom (UK) has an illustrious history of sports clubs. According to HM Revenue and Customs (HM R&C), as at 31 March 2015 there were 6707<sup>141</sup> clubs registered in the UK.

The major sports catered for include football, cricket, lawn tennis and rugby. The United Kingdom also boasts the largest professional football sports clubs.<sup>142</sup> Football club, Manchester United was recently rated as the world’s largest sports club, and like many professional clubs, it pays corporate income tax. There have, however, been some rumblings as to how professional football is accounted for under standard income tax.

The UK revenue authorities introduced the community sports club legislation in 2001 in relation to community sports clubs. The benefits<sup>143</sup> granted to Community Amateur Sports Clubs (CASC) include:

- i. Taxation, gains and profit relief;
- ii. Grant aid repayments on donations; and
- iii. Business rates relief.

Clubs, in order to benefit, are required to register with HM R&C.<sup>144</sup>

Clubs need to decide to either register as a CASC or as a charity, as the Charities Commission does not regulate CASCs. This is significant because sport in the UK is separated from charities, unlike South Africa where one set of rules applies to both sport and charity.

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<sup>140</sup> Ibid P 8.

<sup>141</sup> United Kingdom Government Gov.uk, "Community Amateur Sports Clubs: Detailed Guidance Notes - GOV.UK", *Gov.Uk*, last modified 2015, accessed June 15, 2015, <https://www.gov.uk/government/publications/community-amateur-sports-clubs-detailed-guidance-notes/community-amateur-sports-clubs-detailed-guidance-notes>.

<sup>142</sup> Ibid.

<sup>143</sup> Gov. UK. HM Revenue and Customs Community organisations - guidance Community Organisations and Sports Clubs detailed guidance notes. (2015). Available:

<https://www.gov.uk/government/publications/community-amateur-sports-clubs-detailed-guidance-notes/community-amateur-sports-clubs-detailed-guidance-notes> at 3. Accessed: 15 June 2015.

<sup>144</sup> Ibid at 2.1.

### *Eligibility for recognition as a CSAC*

The rules for CASCs were changed on 1 April 2015. The Commissioner stated that the rules and regulations would improve the operation of the taxation of CASCs.

One of the key changes made was that the qualifying criteria demanded at least 50% of members of the CASC be involved in active sport.<sup>145</sup>

#### 5.1.8 Other conditions<sup>146</sup> are:

- Be set up with a formal constitution.
- Be open to the whole community and have affordable membership fees.
- Be organised on an amateur basis.
- Be set up in the UK, European Union (EU), Iceland, Lichtenstein or Norway.
- Be managed by fit and proper persons.

### *Conditions for registration as a CASC*

As mentioned earlier, the UK made significant changes in respect of CASCs on 1 April 2015. As a result, a CASC will not pay tax if:

- i. Trading profit is less than 50 thousand pounds a year (30 thousand pounds before 1 April 2015).<sup>147</sup>
- ii. Income of up to 30 thousand pounds a year is received from renting out property (20 thousand pounds before 1 April 2015).<sup>148</sup>

The regulation also sets out a limit payable to players employed by the CASC. CASC's cannot pay more than ten thousand pounds in total to all its players.<sup>149</sup>

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<sup>145</sup> Ibid at 1.2.

<sup>146</sup> Ibid.

<sup>147</sup> Ibid at 3.1.

<sup>148</sup> Ibid.

<sup>149</sup> Ibid at 2.15.

Limits are also set for membership fees, which cannot be more than 31 pounds per week or 1 612 pounds per year.<sup>150</sup>

The UK system is clear and concise. UK clubs are liable for VAT once the taxable turnover reaches 82 000 pounds.<sup>151</sup> A voluntary registration exists in order for CASC's claiming business expenses, which can be deducted for VAT purposes, where these are significant and the sports organisation is able to claim the VAT. In a memorandum to affiliated clubs, the English Rugby Union has this to say "this may be favourable if the VAT you are charged on your expenditure is significant and you are able to reclaim that VAT"<sup>152</sup>

If a CASC does not qualify, in terms of the above regulations, it is required to pay corporate tax on any income or capital gains.

If a CASC needs to pay tax, it must complete and file a company tax return. If the CASC does not have a taxable income, it is only required to file a tax return if HM R&C asks for one.

HM R&C will impose taxes and penalties if a CASC does not comply with any of the regulations.

HMRC has commenced the audit of sporting clubs and opened assessments for the non-payment of income taxation.<sup>153</sup> This includes PAYE on player's salaries. Several community based cricket clubs had fines imposed for both interest and penalties for the failure to deduct the appropriate taxes.

It is of further interest that several UK Professional sports bodies such as the English Cricket Board (ECB), Country Cricket Clubs, Lancashire Cricket County and Yorkshire Cricket County<sup>154</sup> have included taxation notes in their annual statements, clearly indicating that the club is liable for income tax.

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<sup>150</sup> Ibid at 2.6.

<sup>151</sup> Gov.uk, "VAT Registration Thresholds - GOV.UK", last modified 2015, accessed June 21, 2015, <https://www.gov.uk/vat-registration-thresholds>.

<sup>152</sup> Rugby Football Union, *A VAT Guide For English Rugby Clubs*, 2013. [http://www.englandrugby.com/mm/Document/Governance/ClubSupport/01/30/44/92/RFU\\_clubs\\_VAT\\_guide\\_Neutral.pdf](http://www.englandrugby.com/mm/Document/Governance/ClubSupport/01/30/44/92/RFU_clubs_VAT_guide_Neutral.pdf)

<sup>153</sup> Gribben, R. "Tax-Relief Changes Are Simply Not Cricket, Sports Clubs Warn HMRC", *The Telegraph*, 2013, accessed June 26, 2015, <http://www.telegraph.co.uk/finance/yourbusiness/10236283/Tax-relief-changes-are-simply-not-cricket-sports-clubs-warn-HMRC.html>.

<sup>154</sup> Yorkshire County Cricket Club, "Annual Report and Accounts 2014," Yorkshire County Cricket Club, last modified 2014.

## Chapter 6

# What is the best taxation structure for sports organisations in terms of the current legislation?

### 6.1 Introduction

All sports bodies need to register with SARS for income tax. This was not a requirement<sup>155</sup> prior to 1 April 2001.

### 6.2 Type of Structure Required

The corporate structure of a sports organisation can be one of the following:

1. A non-profit company incorporated in South Africa;
2. An association of persons formed or established in South Africa;
3. A trust established in South Africa; or
4. A branch of a foreign organisation operating in South Africa that is exempt from tax in the foreign country of origin.

In the case of a recreational club, a trust is replaced by a society formed by a group of persons, which, has a founding document such as a constitution.

Therefore, there is no need for an association of persons to form an NPC or any other company or to register as a Non-profit organisation. Trusts are, however, less prevalent in sport.

### 6.3 Which Taxation Structure Is Applicable to a Particular Sports Body?

It is important to discuss a Non-Profit Organisation as there has been a large degree of confusion regarding the correct and appropriate corporate structure for sports organisations and recreational clubs.

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<sup>155</sup> Section 30 of the Income Tax Act.

## 6.4 The Role of Non-Profit Organisations

Non-Profit Organisations (NPOs) have, for decades, played a pivotal role in South African society. This was recognised by both the Katz Commission<sup>156</sup> and through subsequent changes and insertions in the legislation.

In his 2000 Budget Speech, Finance Minister Trevor Manuel said that, “Non-profit organisations play an important role in society. They assist development by extending social services, often to the poorest of the poor. The Income Tax Act grants tax-exempt status to approved Public Benefit Organisations and allows for donations to certain bodies to be deducted from taxable income. We recognise this does not go far enough. It is for this reason that the government referred the matter to the Katz Commission.”<sup>157</sup>

### 6.4.1 The Non-Profit Organisations Act

The Non-Profit Organisations Act was introduced in 1997, titled The Non-Profit Organisations Act, 1997(Act 71 of 1997). The purpose of the Act is:

- i. *“To provide for an environment in which Non-Profit Organisations can flourish.*
- ii. *To establish an administrative and regulatory framework within which Non-Profit Organisations can conduct their affairs.”*

*The objectives of the Act are set out in section 2 of the Act.*<sup>158</sup> *The objectives seek to:*

- a) *Create an environment in which Non-Profit Organisations can flourish.*
- b) *Establish an administrative and regulatory framework within which Non-Profit Organisations can conduct their affairs, encouraging Non-Profit Organisations to maintain adequate standards of governance, transparency and accountability and to improve these standards.*
- c) *Create an environment within which the public may have access to*

<sup>156</sup> Ibid 36 at p. 2 Ninth Interim Report of the Commission of Inquiry into certain Aspects of the Tax Structure of South Africa.

<sup>157</sup> Manuel, Budget Speech 2000. P 20.

<sup>158</sup> Office of the President Government Gazette, Act No. 71, 1997 Nonprofit Organisations Act, 1997, (Cape Town: Government Printing Works, 1997), <http://www.dsd.gov.za/npo/dmdocuments/NPO%20Act.pdf>.



*information concerning registered Non-Profit Organisations; and*  
*d) Promote the spirit of co-operation and shared responsibility within government, donors and amongst other enlisted persons in their dealings within Non-Profit Organisations.*

The intention of both the Katz Commission and National Treasury was to group similar organisations under one legislative umbrella. However, sports bodies and recreation clubs are not entirely clear of their status. This is mainly a result of these bodies being under the impression that they are amateur, therefore a NPO status suffices for the purpose of amateur sport. Many sporting organisations are of the understanding that applying for NPO status automatically grants them a non-tax status.

There are cases where some clubs have registered as a NPO; under the false assumption this was the only requirement.

Registering as a NPO does not provide any tax consequences. The NPO Act only recognises the body or club as a non-profit or the intention to be a non-profit body. Donors are encouraged by this status, giving them peace of mind that these bodies operate on an upfront and transparent basis. Registration as a PBO also signifies that the sports body is a non-profit entity.

A NPO has the option to register as one of the following:

1. A voluntary association of persons under the common law,
2. A Non-profit Company under the 2013 Companies Act, or
3. A Trust.

The chosen structure must be selected based on the needs of the donor. The most complex structure is the non-profit company and the least complex being the voluntary association, with a trust located somewhere in between.

The choice of structure does not affect the tax status. The tax status clearly falls under the tax legislation and is dealt with under the PBO tax legislation in terms of S30 of the Income Tax Act.

Many sports bodies and recreational clubs receive grants from the National

Lottery, which does not require the donee to be a NPO.<sup>159</sup>

In summary, it is clear that it is not imperative for a sports body or recreational club to be registered as a NPO. Registration as a NPO is generally acceptable and may be dictated by donor requirements. A NPO, however, does not automatically qualify for tax exemption in terms of the ITA. To qualify for this, the body is required to be registered as a PBO.

#### 6.4.2 Are Sports Bodies Required to Incorporate?

As a result of the changes mentioned above, there has been some confusion. Most sporting bodies never incorporated and in essence, under the old section 10(1)(d) of the ITA remained associations of persons. When the PBO legislation was introduced in 2001, sports bodies that were involved in professional and amateur sport placed the professional body in a company, either private or non-profit. The questions that need to be asked are:

- Is it necessary to incorporate?
- Can a sports body operate as an association of persons and still get all the tax allowances?

Section 11E allows the deduction of development and promotional expenses by either a NPC or an association of persons incorporated, formed or established in the Republic. Consequently, a NPC is not the only vehicle that will qualify for the deduction, an association of person will also receive this deduction. One further requirement is that the sporting body has to be engaged in sport or affiliated to a sports code carrying on sport under the National Sport and Recreation Act, 1998.

There are two types of sports bodies, (a) those that are open to the public and (2) a closed grouping, where membership is restricted. The latter is referred to as a recreational club.<sup>160</sup> The former is more wide based and can be a national or provincial sports body. A national or provincial sports body can either partake in amateur or professional sport, or a combination of the two. Recreational clubs are discussed separately below.

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<sup>159</sup> National Lotteries Commission, *Society and Other Lotteries Frequently Asked Questions*, (National Lotteries Commission, 2016), <http://www.nlcsa.org.za/wp-content/uploads/2016/01/FAQ-on-Society-and-other-Lotteries.pdf>.

<sup>160</sup> Section 30A of the Income Tax Act.

## 6.5 Amateur Sport

If the sports body, other than a recreational club, engages solely in amateur sport, it can apply for PBO status in terms of section 30 of the ITA. There are conditions attached to a successful application.

In terms of changes promulgated in 2007, limited trading or business activity is allowed as long as it is directed to the main activity of the PBO, namely the promotion of amateur sport. In addition, the business activity is based on recovery of costs and the activity must be of a non-competitive nature. If all three conditions are satisfied, the sports body can be approved as a PBO under section 30.

The main factor is the promotion of amateur sport. Amateur sport is not defined in the ITA. The Oxford Dictionary defines amateur sport as the pursuit of sport without being paid. Professional sport is defined in the Oxford Dictionary as “Engaged in a specified activity as one’s main paid occupation rather than as an amateur”.<sup>161</sup>

A sports body approved as a PBO can obtain sponsorship as long as the sponsorship is directed at the promotion of amateur sport. It is interesting to note that SASCOC has been approved as a PBO. SASCOC recently successfully bid, on behalf of South Africa, to host the 2022 Commonwealth Games. SASCOC does procure sponsorship both in cash and kind. However, the key factor is the fact that SASCOC does not pay athletes to compete. Athletes competing in the Olympic Games are prevented from receiving salaries but can have costs incurred refunded and can receive incentive bonuses for winning a medal. Likewise, an athletics body receiving in-kind sponsorship, such as carbonated drinks for races, may find such income to be exempt from taxation on the grounds that the sponsorship allows the athletics body to carry out the mandate of carrying out amateur sport. The monetary value is of little consequence.

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<sup>161</sup> *Oxford Dictionaries - Dictionary, Thesaurus, & Grammar* "Amateur - Definition of Amateur in English from the Oxford Dictionary," accessed February 27, 2016, <http://www.oxforddictionaries.com/definition/english/amateur>.

The other advantage is an exemption of the greater of 5% of gross receipts or R200 000 afforded to registered PBOs where the PBO engages in taxable activities.

## 6.6 The Amalgamated Sports Body

If the sports body administers both amateur and professional sport, there are two options. The first is to split and separate amateur from professional sport into two separate entities. The one body looks after professional sport while the other body, a PBO, looks after the interest of amateur sport. However, this has been found to be cumbersome so changes were mooted in 2006 whereby the sports body can operate as one. Section 11E and section 24E were introduced to accommodate this change.

The changes discussed above can apply to both national and provincial sporting bodies.

## 6.7 Recreational Clubs

Recreational clubs missed the initial wave of legislation in 2001. However, in 2007 conditions under which recreational clubs were to operate became law.

All recreational clubs have to register with SARS. This includes non-sports clubs or societies. Clubs and societies need to register in terms of section 30A of the ITA.

## 6.8 The Basic Rules Applicable to Recreational Clubs

Recreational clubs often engage in business or trading activities which are clearly taxable. As long as the activities provide for the recreational or social needs of members, no taxation will accrue to the income earned from these sources, making it free from taxation. Certain activities border on the definition of business or trade activity. As long as these activities provide for the recreational needs or social needs of members, such activity will be free from taxation even if they are provided to non-members.<sup>162</sup>

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<sup>162</sup> Section 10(cO)(ii)(aa) of the Income Tax Act.

Recreational clubs are required to cleverly structure their activities. For example, consider a golf club. Income from the hiring of golf carts will be exempt from taxation as the carts provide a service to members in order to partake in recreational activities. Most golf clubs have pro shops, which take and manage bookings for both members and non-members. Due to the shop providing a service to members, income from the shop may be exempt from taxation. However, if the pro shop is outsourced, the rental income is subject to taxation.

If recreational clubs receive sponsorship, it may be better for the club to receive it in the form of in-kind, so that it benefits all members, thereby avoiding income tax.

All facilities hired out for rental will be subject to income taxation as these do not relate to the provision of facilities for members.

Recreational clubs receive a basic tax exemption of the greater of 5% of membership fees or R120 000 per annum on non- exempt income.<sup>163</sup>

In conclusion, sports organisations will have to decide what is the best structure based on the standing of the sports body and taking into account all the applicable provisions in the ITA relating to the organisation.

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<sup>163</sup> Section 10(cO)(iv) of the Income Tax Act.

## Chapter 7

### 7.1 Conclusions and Recommendations

To conclude, it is clear that a number of issues highlighted require clarity. These are further discussed under separate headings below.

### 7.2 Structure of the Sports Organisation

The many teleconference calls and conversations with sports administrators highlighted that the biggest point of confusion has been the most appropriate structure given the fairly new legislation and subsequent changes.

Sports administrators are confused as to which is the most appropriate structure, citing a NPO, NPC or an association of some sort. People are generally fearful of taxation; however, SARS is in the best position to remedy this situation. It is recommended that SARS work with SASCOG in order to gain the confidence of all sports organisations. This can be achieved by engaging with national and provincial sports organisations.

### 7.3 Section 24E

It is recommended that SARS must clarify the application of section 24E. The lack of clarity is causing uncertainty in that it is not clear if this section applies to major events or to any event. I recommend that the legislation be explicit. It is proposed that SARS consider scrapping this section as only a few sports bodies will be affected by section 24E and instead SARS should grant amalgamated sports bodies complete tax exemption for amateur sports transactions. Place them in the same position if they operated a PBO and a professional section. As a result this will remove any confusion created in interpreting S24E. Sports organisations will then be appropriately rewarded for spending excess income from professional cricket on development and promotion.

## 7.4 Recreational Clubs

Having spent more than 30 years as a sports administrator, I firmly believe that South Africa should follow the UK's HMRS (RS) which sets an upper limit for the submission of tax returns on an annual basis.

While there are a number of recreational clubs in South Africa, these are very different in financial and administrative status. The majority of recreational clubs are poor and as the CEO of WP Cricket recently told me, the majority of clubs could not even afford cricket balls to play their cricket on a weekly basis.

Many of these clubs are run on an informal basis. An upper limit of R500 000 gross income for annual submission of an income tax return will not deprive the *fiscus* of significant tax revenue.

SARS can still exercise control by requiring registration as a taxpayer and will still be in a position to request the information on an annual basis if necessary.

## 7.5 Better Packaging of Legislation

Both the revenue authorities in the UK and Australia have managed to successfully separate legislation affecting sport from ordinary charities. Furthermore, HMRS in the UK runs an effective web site showing who is registered and provides valuable statistics. The web site assists sports clubs by procuring sponsorships and donations from prospective donors. It is a good reference point indicating that the sports organisation is genuine. I recommend that South Africa follow this route.

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# Appendices

## APPENDIX 1

### The Katz Commission's findings in relation to sport organisations

#### Introduction

As a pre-cursor to the PBO legislation, the South African Government appointed the Katz Commission in 1994 to investigate all aspects of taxation. The Commission started its work on 22 June 1994.<sup>164</sup>

The terms of reference included an investigation into Non-Profit Organisations as sport was incorporated into the investigation.

Recommendations were made in the Ninth Interim Report,<sup>165</sup> where fiscal issues affecting Non-Profit Organisations (NPOs) were investigated, and recommendations were made to national government.

#### The Introduction to the Ninth Interim Report

The Commission identified two areas within existing financial laws that required review and amendment:

1. The exempting provisions contained in section 10 of the Income Tax Act (ITA), deals with exemptions for religious, charitable and educational institutions of a public character and any fund which has as its object to provide funds for such institutions and
2. The provisions of S 18A of the ITA that restricts the benefits of donor deductibility to institutions mentioned above.

The committee accepted that the tax advantages applicable to NPOs had to be retained.

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<sup>164</sup> Department of Finance, *Republic of South Africa Department of Finance Budget Review 1994*, (Cape Town: National Department of Finance, 1994),

<http://www.treasury.gov.za/documents/national%20budget/Budget%20Review%201994.pdf>. P 2.5

<sup>165</sup> Department of Finance, *Republic of South Africa Department of Finance Budget Review 1994*, (Cape Town: National Department of Finance, 1994), <http://www.treasury.gov.za/documents/national%20budget/Budget%20Review%201994.pdf>.

“There is virtual unanimity of opinion and authority regarding the importance and justification for retaining the privileged tax status of NPO’s and extending the ambit and reach thereof”.<sup>166</sup>

The Commission and National Treasury at the Medium Term Review in 2001 agreed that NPOs play a significant role in promoting democracy, relieving the burden of poverty and delivering social services to the people of South Africa.

The Commission stated that for the long-term reform of the South African tax system, a holistic evaluation of the tax system was required.

Following recommendations, the Commission embarked on a holistic evaluation of the tax system.

### Analyses of the Ninth Interim Report

The report was submitted to the President of the Republic of South Africa on 12 February 1999. The Commission appointed two subcommittees to look into the following broad themes:

1. The principle exempting provisions are contained within section 10 of the Income Tax Act no 58 of 1962 (as amended) (“the Act”), including subsections 10 (1) (fA) and 10 (1) (FA), which dealt with:
  - a. Religious, charitable and educational institutions of a public character [section 10 (11)(fA)],
  - b. Any funds, the sole objective of which is, to provide income for any religious, charitable or educational institution contemplated in paragraph (f) [section 10 (1) (fA)],
  - c. The provisions of the Act (section 18A) restrict the benefits of donor deductibility to universities, colleges and educational funds (as defined),
  - d. A deduction from taxable income not succeeding:

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<sup>166</sup> Ninth Interim Report of the Commission of Inquiry into certain Aspects of the Tax Structure of South Africa (Katz Commission) FISCAL ISSUES AFFECTING NON-PROFIT ORGANISATIONS (NPOs) (2000). Available: <http://www.polity.org.za/polity/govdocs/commissions/katz1-2.html> at 1.6.6. Accessed 7 June 2015.

- i. In the case of individuals, five hundred rand (R500) or 2% of taxable income, and
- ii. In the case of companies, five percent (5%) of taxable income.

The report did not specifically address sporting bodies nor did it refer to section 10 (1)(cd), the exemption affecting amateur sports bodies.

The issue of sporting bodies was dealt with in the final recommendations of the Ninth Interim Report,<sup>167</sup> which stated, “That the legislation should contain a schedule listing eligible public benefit activities, which might include:...recreation and sport...” This led to sports bodies being categorised with a range of NPOs with the final inclusion in the Ninth Schedule of the ITA.

The sub-committee received a number of representations from a large number of bodies affected by the legislation. However, it received no submissions from sporting bodies.<sup>168</sup>

The vast and varied submissions centralised around a common theme, special tax statuses that are applicable to NPO’s should be retained.

“Whereas these sources and submissions differ in the emphasis upon particular needs and objectives, there is virtual unanimity of opinion and authority regarding the importance and justification for retaining the privileged tax status of NPO’s and extending the ambit and reach thereof.”<sup>169</sup>

The sub-committee also took into account the tough financial constraints faced by NPOs and the need to supplement donor funds.

The sub-committee acknowledged that many countries recognise the role played by NPO’s and the “desirability of supporting NPO’s by granting the same preferential tax treatment and donor incentives, although the eligibility criteria, the benefits available, and the fiscal methodology differ in many circumstances.”

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<sup>167</sup> Ibid at Paragraph 6.1.4.

<sup>168</sup> Ibid Annexure A Page 30.

<sup>169</sup> Ibid Paragraph 2.2.2.



## Problems with the Existing Legislative Framework

At the time of the investigation, the Commission highlighted the following problems with the legislative framework:<sup>170</sup>

- The antiquated language of the legislation.
- Lack of CSARS resources and case law.
- The long checklists with no actual fiscal qualifying conditions.
- Defining terms and “income”, “expenditure” and “trading”, and differentiating between capital and revenue.
- The tax benefits available to donors, provides an expectant benefit to hard pressed Non-Governmental Organisations (NGO’s).

## Evaluation as an NPO by CSARS

It was clear that as part of the system being investigated by the sub-committee, CSARS was required to evaluate the application of NPOs. The former Commissioner of South African Revenue Service (CSARS) regarded this as a costly expense. Little or no case law exists around this issue, (the success or failure of an application) resulting in CSARS not providing, as it is required to do, detailed technical reasons why an application for NPO status is declined.<sup>171</sup>

## Defining Criteria

The sub-committee also acknowledged the difficulty with eligibility criteria for approving a NPO.<sup>172</sup> A proper framework of what a NPO would need to comply with for a successful application was required, because in the absence of this, decisions by SARS could be seen as arbitrary.

## Drafting Considerations

The sub-committee acknowledged it was necessary to devise formulations that were clear, flexible and had reference to objective criteria.

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<sup>170</sup> Ibid at Paragraph 3.

<sup>171</sup> Ibid at Paragraph 4.

<sup>172</sup> Ibid at Paragraph 5.3.

In addition, the sub-committee recognised that, in order to be successful, the qualifying criteria must be clear and feasible. The sub-committee also proposed that section 18A, which itself is subject to three pages of definitions must be reduced to plain language.

The Commission concluded by agreeing that the government has to consider the benefits in the context of its own development priorities.

### Trading Activities

The Commission acknowledged that NPOs should not be restricted from trading.<sup>173</sup> These organisations should be encouraged so that NPOs become financially independent.

### Unfair Competition

The Commission made it clear that further steps may need to be taken on “unfair competition” between bodies subject to tax and those that are tax-exempt.<sup>174</sup>

“The broad issue of fairness or equity within a free-market economy is a fundamental one that warrants some degree of vigilance. However, the Commission is of the view that this value should not be evaluated to the status of a “summum bonum”<sup>175</sup>(the highest good) and needs to be counter-balanced with other important values in society, including the need for a strong, independent and viable NPO sector.”<sup>176</sup>

The Commission however, recommended that some “ceiling” be set where NPO’s receive tax-free treatment. It was recommended that the statutory exemption of trading income should be restricted to the trade derived from the privacy purpose of the charity.

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<sup>173</sup> Ibid at Paragraph 5.6.

<sup>174</sup> Ibid at Paragraph 5.10.

<sup>175</sup> *Oxford Dictionaries - Dictionary, Thesaurus, & Grammar* "Amateur - Definition of summum bonum in English from the Oxford Dictionary," accessed February 27, 2016, <http://www.oxforddictionaries.com/definition/english/summum-bonum>.

<sup>176</sup> Ibid at Paragraph 5.10.1.

## Donor Deductibility

The Commission sought to identify a means of expanding the present scope of donor deductibility as envisaged by section 18A as part of its investigation. The Commission examined all aspects of section 18A.<sup>177</sup>

“Accordingly, the Commission proposes, as an interim measure, a broadening of the provisions of the existing section 18A to permit a broader category of eligible organisations that would be entitled to grant-donor benefits similar to those presently reserved for educational institutions and funds.”<sup>178</sup>

The Commission recommended section 18A be expanded to include donations to a wide range of organisations as listed in the Ninth Schedule to the ITA.

## Specific Recommendations

After reviewing current legislation and practice, and in the light of international precedent and experience, some of the key recommendations, other than those mentioned above, of the Commission are:

- (a) Donations: Consideration should be given by the government to allow donations to specific categories as social needs arise in a particular budgetary year. This can be altered from year to year and the quota to be allowed is dependent on natural budgetary restraints in a particular year.

In addition, the Commission recommended that the provision relating to Donations Tax be amended. Restrictions to be amended to include organisations proposed in the list of organisations subject to section 10 (1)(f).

- (b) Investing of Funds: The Commission also recommended that restrictions on NPO’s to invest money be rescinded.

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<sup>177</sup> Ibid Paragraph 5.14.

<sup>178</sup> Ibid Paragraph 5.14.5.

1. Trade: With respect to trading, the Commission recommended that the fiscus introduce a restriction to prevent abuse.
2. Estate Duty: It was suggested that Estate Duty also be amended to allow bequests to approved organisations in terms of section 10 (1)(f) of the ITA.
3. Exempting Other Taxes: The Commission found no grounds for exemption of other taxes such as Value Added Tax (VAT) by NPOs.<sup>179</sup>

### The Government's Reaction to the Ninth Report of the Katz Commission

The South African Government responded immediately to the Ninth Katz Commission Report through Finance Minister, Trevor Manuel. The Minister stated in his 2000 Budget Speech, "Having considered the Ninth Report of the Katz Commission and the preliminary findings of the Portfolio Committee on Finance, it is proposed that provision be made for a new definition of "Public Benefit Organisations", which would qualify for tax exemption."

All the exemptions in respect of NPO's, including sport, were repealed and replaced by a new overarching exemption.

Section 10 of the Income Tax Act was amended by deleting paragraphs (cB) (Co-operatives),(cC) (S21 Company building residential dwellings), (cD)(Amateur sporting association),(cF) (Ecclesiastical, charitable and educational institutions) ,(cI) (S21 company acquiring and developing land in SA for people earning less than R1800 per month),(cJ) (Company raising to fund cl), f and (fA) of subsection I (Religious, charitable and educational institutions), deletion of paragraph (cK) of subsection (I) (Supply of electricity in terms of S124 of the constitution). It was replaced by paragraph (cM) of section 10(1) of the Income Tax Act.

The inserted section 10(1)(cM) states that, "*The receipts and accruals of any public benefit organisation which has been approved by the Commissioner in*

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<sup>179</sup> Ibid at Paragraph 6.3.4.

*terms of section 30(3)*”.

As an outcome, receipts and accruals are exempt from tax if the PBO has been approved by SARS. Section 30 of the Income Tax Act<sup>180</sup> was added to specifically deal with PBOs.

### A Summary of Section 30 of the Income Tax Act

A public benefit organisation is determined by the Minister of Finance through publishing a list of acceptable conditions in the Government Gazette. A PBO is defined in S 30 of the ITA as:

1. A non-profit company incorporated in South Africa,
2. A trust, or
3. An Association of persons carrying on one or more such Public Benefit Activity in the Republic.

The sole objective is to carry out a Public Benefit Activity that is non-profit in nature with “an altruistic or philanthropic intent.” However a PBO can carry on a trading activity subject to certain conditions. It is obliged to carry out all such activities in the Republic, unless the Minister, having good regard to the circumstances of the case, directs otherwise.

A Minister shall determine, by notice in the Gazette, any activity, which is philanthropic and benevolent, after taking into account the needs, interest and wellbeing of the general public.

To qualify as a PBO, a suitable entity must conform to the following:<sup>181</sup>

- i. Comply with conditions laid down by the Minister from time to time.
- ii. Provide SARS with a copy of its Constitution or a similar document.
- iii. Appoint three persons, who are not connected, to accept fiduciary responsibility for such organisation.
- iv. Prohibited from distributing funds and is required to utilise such funds for the sole objective for which it was established.

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<sup>180</sup> Sections 21(1)(c) and 35(1) of the Taxation Laws Amendment Act 30 of 2000, which came into operation on 15 July 2001.

<sup>181</sup> S30(10(a) of the Income Tax Act.

- v. Required, on dissolution, to transfer its assets to any similar public benefit or organisation so approved.
- i. Business activity entered into is the greater of 15% of turnover or R 25 000, and the activity is related to its main objective and centred out “on a basis substantially the whole of which is directed towards the recovery of cost and which would not result in unfair competition in relation to taxable entities”.
- vi. If the activity is not related to its sole objective, such activity is undertaken on an occasional nature.
- vii. The undertaking or activity is approved by the Minister.
- viii. A PBO may not accept donation which is revocable.
- ix. Amendments to the constitution must be submitted to SARS.
- x. It must not participate in a tax scheme.
- xi. All employees are paid market related salaries.
- xii. Complies with reporting requests determined by SARS.

In 2006, further changes were made regarding PBOs trading within certain parameters. When the original PBO legislation was made law, a trading activity had to be transferred to a separate entity, failing which the PBO would lose its status.

The amendment in 2006 allowed for a system of partial taxation. Business activities within certain parameters would be fully taxable. PBO activities would remain untaxed. The amendment became effective on 1 April 2006. This was especially applicable to sports bodies as they had both taxable and non-taxable activities. As a result, it became a cumbersome process to administer as separate entities had to be created for each of the activities.

### Issues Specific to PBOs - Basic Exemption, Tax rates and Administration

The ITA provides the following conditions:

- Where the PBO receives income and accruals from a business activity the PBO will receive a basic exemption of the greater of 5% or R 200 000 in terms of section 10(cN)(ii)(dd).

- PBOs are taxed at 28% and do not pay provisional tax.<sup>182</sup>
- PBOs must retain financial information for four years from date of transaction.
- PBOs must submit an annual tax return.
- The TAX Exemption Unit (TEU) can withdraw a PBOs status if it fails to comply with section 30 or its founding statement.<sup>183</sup>

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<sup>182</sup> Paragraph (aa) of the exclusions to the definition of “provisional taxpayer” in paragraph 18 of the fourth schedule of the Income Tax Act.

<sup>183</sup> Section 30(5) of the Income Tax Act.