

Creating an enabling environment for impact investment in South Africa

Taxation and Public Benefit Organisations

Report 2 in our three-part series



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Impact**



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About Krutham

Krutham works with clients across the spectrum of capital, from profit-led investment in emerging markets to philanthropy. We work with investors, banks, capital market infrastructure providers, corporates, insurers, law firms, development agencies, multilaterals, governments and philanthropies to develop products and systems that help mobilise finance to deliver better social outcomes. It has offices in Johannesburg and London.

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Note on Process - Public Comment Stage

This version of the preliminary research report has been released for public comment by interested parties. Please use the website form where you downloaded this report to submit your comments or questions.

The deadline for submission of comments is **Tuesday 22 April 2025**.

Krutham will be hosting a series of invitation-only workshops in early May 2025 to discuss the feedback and recommendations on each report. Please register your interest for these workshops on the website.

Disclaimer

This report is based on information believed to be reliable, but Krutham makes no guarantees as to its accuracy. Krutham cannot be held responsible for the consequences of relying on any content in this report.

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Abbreviations

CIPC – Companies and Intellectual Property Commission

DSD – Department of Social Development

ITA – Income Tax Act

NPO – Non-Profit Organisation

PBO – Public Benefit Organisation

SARS – South African Revenue Service

SBFE – Small Business Funding Entity

Glossary of terms

Impact investing	Investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return. <i>(as defined by the Global Impact Investing Network)</i>
Micro-business	A type of special taxpayer recognised under South African tax law where the primary qualification is turnover of less the R1 million pa, and which operates either as a company or a sole trader.
Mission-related investing (MRI)	Investments undertaken at the endowment level and involve allocating some (rarely all) of the foundation's investment portfolio to investments that deliver impact.
Programme-related investing (PRI)	Investments undertaken as part of a foundation's programmes alongside grant-making, such as small loans and grants to support businesses that can deliver impact aligned to the programme's objectives.
Small Business Corporation	A type of special taxpayer recognised under South African tax law where the qualifying criteria include being a juristic entity (eg a company), with only natural persons as shareholders, and with gross income of less the R20 million pa.
Social enterprise	An organisation that uses commercial strategies to achieve social, environmental, or community objectives, prioritising social return ahead of financial profit.

Executive summary

South Africa's tax legislation recognises the significant role played by non-profit entities in dealing with social challenges in the country. The legislation provides for non-profit entities to operate under a special status that exempts them from paying income tax thus allowing more financial resources to be devoted to the causes they serve.

However, there is no over-arching tax policy or legal framework in South Africa that governs the growing phenomenon of impact investing. Furthermore, the conceptual framework that underpins the current income tax legislation for non-profit entities has not adapted to the possibilities created by the growing local and international interest in impact investing – possibilities that create the potential for more funding to flow into this vital sector for it to expand the reach of its work. Given that non-profits undertake public benefit activities, expanding their impact ultimately means greater public good is delivered through impact investing than through traditional grant-making.

Research conducted by Krutham suggests that while many aspects of the existing tax legislative framework work well, more flexibility and clarity is needed to encourage innovations in the non-profit sector to support their own financial sustainability. Greater use of patient, philanthropic capital and attracting commercial capital into hybrid investment vehicles will enable non-profit entities to support vulnerable communities, education and unemployment programmes and emerging small businesses at a scale not hitherto witnessed in South Africa.

Our preliminary recommendations as presented in this policy brief are:

- Increase the thresholds for business or trading activities for Public Benefit Organisations and Small Business Funding Entities.
- Relax the current requirement for business or trading activities to be linked to the "core" purpose of the PBO, replacing this with a requirement for all profits made from such activities to be reinvested in furthering the mandate and objectives of the PBO.
- Align Part I and Part II of the 9th Schedule of the ITA and establish the working practice that the items listed in these parts are not a definitive list but rather a source of guidance for non-profit entities wishing to apply for PBO status.
- Draft and promulgate the regulations for lending activities under Part 1 (1) (pⁱⁱⁱ) of the 9th Schedule and consider the extension of lending to fields other than poverty alleviation.
- Further reduce the distribution requirement for a Conduit PBO in section 18A from 50% to 25% to align with the equivalent SBFE requirement and extend the period in which such distributions need to occur from 12 months to five years.
- Consider creating a new type of taxpayer – a "social enterprise", as has been introduced in various other jurisdictions.
- Clarify that an SBFE may undertake a wider range of activities in addition to the provision of funds, such as business support, technical assistance and mentoring; and permit an SBFE to hold equity interests in its portfolio of beneficiaries, to cater for the new and emerging forms of financial instrument such as convertible grants and hybrid debt instruments that can convert into equity.
- Permit lending by non-natural persons to micro enterprises and Small Business Corporations to try to stimulate the uptake of these forms of special taxpayer.
- Consider presenting a more public face to the Tax Exemption Unit, such that the results of its work, and its approach is more visible to the impact investing, PBO and SBFE community.

Engagement with stakeholders on these draft recommendations will refine these recommendations for final publication and a process of policymaker engagement.

About this report

Impact investing has the potential to deliver extensive social benefits for South African society but we need a conducive regulatory environment to realise this potential. In this research brief, we present a set of proposals to stimulate and regulate impact investing in South Africa. We believe these should be considered in three domains: instrument design and disclosure; tax regulation; and the B-BBEE framework.

Background

Impact investors desire not just financial returns but returns in the form of measurable improvements in societies and their environments. Impact investing has the potential to generate positive social and environmental outcomes in addition to a form of financial return.

With the ability to mobilise both private and public savings, this form of investment has the potential to deliver outcomes that lead to better lives for South Africa's people. Governments around the world are actively encouraging it as they've recognised the importance of stimulating investment markets to support projects that have positive social and environmental outcomes.

From a public policy perspective, impact investing is a "no brainer" given that allocating investment in a way that has positive public outcomes creates public benefits "for free". Investing already achieves public benefits simply by financing economic activity; impact investing leverages that to achieve greater public benefit. This does not displace traditional investing but rather focuses on increasing the public benefits. For fiscally constrained governments, eager to mobilise private finance to achieve public policy objectives, impact investing is a clear opportunity.

The South African regulatory environment as it stands presents challenges to impact investing. This is limiting the potential for investment to help achieve the country's development objectives. This discussion document envisages a comprehensive process to review the regulatory environment as it affects impact investment and make recommendations for changes that will lead to a thriving impact investing sector with the resulting public benefits. It examines three areas that are critical to reform to stimulate and support impact investing:

Track 1: Instrument design and disclosure

Extensive work is being done worldwide on disclosure requirements for investment instruments that take on a sustainable investing or impact label. Such labels are part of the proposition to clients. In order to allocate their money effectively, clients who desire impactful outcomes need reliable labels and other disclosures by investment funds and instruments. A fund that calls itself an impact fund must meet the necessary and sufficient conditions to count as an impact fund. Such conditions need to be regulated to ensure appropriate conduct by providers, and be in clients' interests, with labels serving as a signal of that compliance.

Impact investments have several unique characteristics. Unlike traditional investments, they are usually not listed on public capital markets, given that the funding often supports development activities that do not fit traditional corporate structures, though there are several listed instruments such as green bonds and sustainability linked notes that are impact instruments. Another differentiating feature is that they can be illiquid, with long time horizons before the realisation of returns. They also must serve two objectives: financial and social/environmental outcomes, with reporting and measurement requirements for both.

Globally, sustainable finance and impact disclosure frameworks are being developed, which can be embraced by regulators by defining certain instruments. This may require unique regulatory instruments that accommodate illiquid assets and have both impact and financial measurement and disclosure requirements.

Relatedly, regulation should support investors to incorporate such instruments into their investment strategy where appropriate, including institutions like foundations, pension funds and insurance companies.

Track 2: Taxation and public benefit organisations

This theme is the focus of this document because the vanguard of impact investing worldwide has been public foundations. These are non-profit organisations that have large investment endowments. Traditionally those endowments have been invested in debt and equity instruments through public capital markets to generate a return that finances their programmes. But these foundations have over time come to recognise that their endowment portfolios can be managed, at least in part, in a way that achieves positive impact in line with their overall mission. They have therefore become more active managers of their portfolios and are using a portion of portfolios for “mission-aligned investing”. Foundations can also supplement their traditional grant-making activities by introducing investing instruments as part of their programmes, such as small loans, which potentially allow grant monies to be recycled and increase impact (this is often called “programmatically investing”).

Globally, foundations are learning that through impact investing they can magnify the difference they make in the world. Impact investing enables them to catalyse their limited financial resources to have a much greater impact than through grant-making programmes alone. Given that foundations undertake public benefit activities, this scaling of their impact ultimately means greater public good is delivered through impact investing than through traditional grant-making.

However, when a foundation becomes an active manager of a portfolio that has both impact and financial objectives, there is a risk that such activities conflict with tax-based restrictions on non-profit activities, and foundations risk losing their tax exempt status. This risk discourages foundations from engaging in impact investing even though it has clear public benefit consequences. The ambiguities and risks around the tax status of impact investing must be resolved to stimulate greater impact investing activity by foundations and other non-profits.

Track 3: B-BBEE framework

The broad-based black economic empowerment framework involves impact investing, though it is seldom referred to as such. Empowerment transactions that aim to deliver transformation of the economy are impact investments by another name, as are the enterprise and supplier development components on the B-BBEE scorecard. Supplementing those is the socioeconomic development component which drives direct investments that improve socioeconomic outcomes, often made in the communities surrounding a business's operations. There are also sector-specific B-BBEE targets – banks, for example, get empowerment points for ensuring access to banking facilities in rural or other underserved areas.

By delivering on the empowerment components, companies supplement financial returns with the impact objective of achieving transformation.

The B-BBEE framework, however, is activities-based and does not focus on the impact created by these activities. Rather, it measures the inputs – usually that is the money spent or invested, the number of employees sent on skills training, etc. In contrast, impact investing has formalised the measurement and management of impact, ensuring it is not just the money invested but the impact delivered that is assessed. That is what guides decision-making.

While B-BBEE has many features of impact investing, specifically the broad objective of delivering social impact alongside traditional investing, it has been primarily focused on inputs and activities rather than outputs. As part of building the impact ecosystem in South Africa, there may be opportunity to enhance the impact of B-BBEE by aligning it with broader impact investing methods and approaches to deliver transformation. This track of the research project will review the opportunities and make recommendations.

Methodology / approach

Our recommendations for South African policymakers have been developed to support addressing the aforementioned challenges. The recommendations are the outcome of both **research** and **engagement** with key stakeholders – including regulators and policymakers – which ensures that any proposals for the way forward are appropriately ambitious, but pragmatic.

The methodology applied to this work consists of three phases:

1. Developing a draft policy paper on each of the three key focus areas (**this document**).
2. Circulating and workshopping the paper with relevant stakeholders to enable a co-creation process for developing the final draft paper.
3. Gathering feedback on the draft policy paper and incorporating commentary to develop the final draft report.
4. Initiating a policy engagement process with relevant stakeholders.
5. Finalising policy recommendations.

Impact Investing

There are several definitions of the term “impact investing”. The Global Impact Investing Network’s definition is: “Investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return.” (Global Impact Investing Network (GIIN), 2019)

The diagram below illustrates how impact investing is growing in appeal for both philanthropic organisations and asset managers alike.

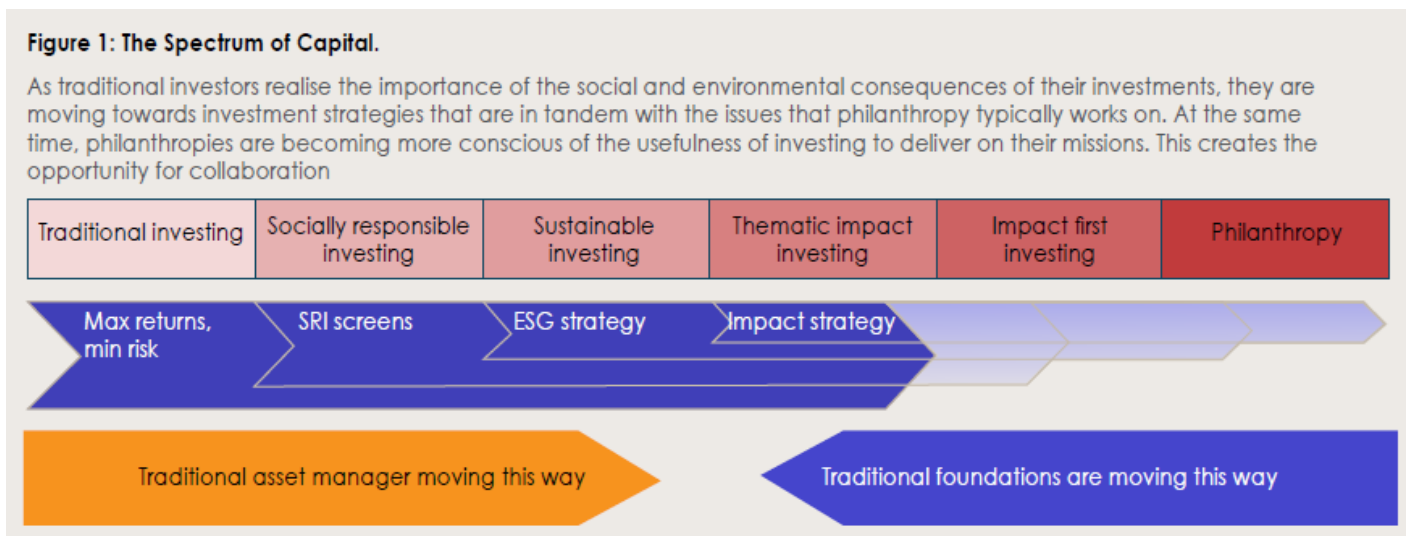


Figure 1: The Spectrum of Impact Capital

(Source: Krutham)

The GIIN Impact Investing Guide describes four “core characteristics” of impact investing:

1. **Intentionality:** An investor’s intention to have a positive social or environmental impact through investments is essential to impact investing.
2. **Investment with return expectations:** Impact investments are expected to generate a financial return on capital or, at minimum, a return of capital.

3. Range of return expectations and asset classes: Impact investments target financial returns that range from below market (sometimes called concessionary) to risk-adjusted market rate, and can be made across asset classes, including but not limited to cash equivalents, fixed income, venture capital and private equity.
4. Impact measurement and management: A hallmark of impact investing is the commitment of the investor to measure and report the social and environmental performance and progress of underlying investments, ensuring transparency and accountability while informing the practice of impact investing and building the field. (Global Impact Investing Network (GIIN), 2019)

Problem statement

South Africa's tax legislation recognises the role played by non-profit organisations in the social fabric of society, exempting those which qualify under the public benefit organisation regime from income tax and, through the VAT Act, allowing them to become VAT vendors. Donations to registered Public Benefit Organisations (PBOs) can also be exempt from donations tax and be made from the pre-tax income of companies and individuals, subject to limitations based upon a percentage of taxable income of the donor.

Yet for foundations and other investors who are looking to achieve a blend of social and financial impact by deploying their investment capital to actively build the instruments and the market itself for impact investing, the existing taxation regime for PBOs does not provide sufficient clarity nor flexibility for the widespread adoption of impact investing either for "mission-related investing", nor for "programme-related investing". Many potential participants in this nascent market are reluctant to pursue either of these routes because of this.

In essence, the conceptual framework underpinning the current PBO dispensation in South Africa is not aligned with the emerging opportunity for impact investing activities (both programmatic and mission-aligned) to address pressing policy and market failures and ultimately benefit the most marginalised people of this country. Rather, it conceives of public benefit activities as the making of charitable donations to needy individuals, not the undertaking of activities that support those needy individuals through ways other than donations.

The tax regime for non-profit entities in South Africa has itself evolved significantly since the late 1990s, following recommendations by the Katz Commission in 1999. The current designation of "Public Benefit Organisation" and the accompanying list of "Public Benefit Activities" (See Appendix 1) is largely a product of those recommendations, becoming effective following legislative amendments in 2001 and again in 2006 and 2014. Indeed, the significant role played by non-profit entities in South Africa is recognised by the South African Revenue Service (SARS) and National Treasury, taking a "shared responsibility for the social and development needs of the country" the financial burden of which would otherwise fall on the state (South African Revenue Service, 2014). The importance of charitable giving has also been recognised with progressive increases in the maximum amount of donations that can be deducted from taxable income rising from 2% to 5% and subsequently 10%.

PBOs may invest in portfolios but this must be to generate passive income that can fund their PBO activities. As a result, foundations with endowments generally outsource the management of their investments to a traditional investment manager who invests it in standard investment portfolios. These seek an appropriate risk-adjusted return, but do not normally assess the impact of the investment activities nor evaluate whether they advance or hamper the achievement of the public benefit activities that the PBO seeks to achieve.

The environment in which many non-profit organisations operate today in South Africa has continued to evolve since the early 2000s when the core of the current tax legislation affecting non-profit entities was

promulgated. Impact investing has developed internationally as a means for investors to seek a blend of social and financial outcomes, while the emergence of well-funded corporate foundations from maturing B-BBEE transactions post 2015 has added a new type of player to the landscape: organisations with substantial investment portfolios that are eager to pursue the transformational mandate that gave rise to them in the first place. Against this, the economic realities post the global financial crisis have provided funding challenges for many traditional non-profit entities that rely on annual donations, an issue that was particularly stark during the Covid-19 period and has become stark again with major changes to the work of (and funding provided by) USAID.

The pressing social issues that many non-profit entities seek to address in South Africa remain stubbornly intractable, with notably high levels of absolute poverty and unemployment, especially among youth aged between 16 to 34. Impact investing (for blended value) is a nascent form of investing into social causes that offers the opportunity to unlock significant amounts of funding tied up in traditional asset classes and direct this into projects that directly address these and other social challenges. Some of these projects are operated by traditional charitable organisations, while others fall under an emerging form of business known as a "social enterprise".

The current conceptual model underpinning the PBO regime in South Africa is suitable on the one hand for a traditional donor-funded charity model and on the other for the traditional generation of passive investment income from endowment assets. But it contains restrictions, ambiguities and gaps in its laws and regulations that are hampering the wider adoption of impact investing. As noted by the Davis Tax Committee (Davis committee) "As a result, donors who are seeking to commit to sustainable, longer-term philanthropy through the setting up of a funding foundation/organisation are dis-incentivised to do so. This rule hampers the build-up of an endowment within such a foundation." (Davis, 2018).

Globally, policy and regulatory frameworks are emerging to support the growth of the market for impact-focused investment and this has included taxation, with specific laws and regulations designed to support such growth.

With significant levels of dependency on the state in South Africa for poverty relief through grants, initiatives that can unlock private capital to fund socially beneficial activities represents an obvious "win" for the country. Substantial public good can arise from stimulating the impact investing market, and a trade-off with other policy objectives of the government need not be the outcome.

The taxation of public benefit organisations in South Africa

The need for debate on the taxation of PBOs

In many countries, non-profit organisations are provided with a degree of beneficial or even preferential tax treatment. As noted in the Problem Statement section, following recommendations made by the Katz Commission in 1999, a significant revision of the South African taxation laws was undertaken, the product of which is today's regime of Public Benefit Organisations, a special status granted to qualifying taxpayers (which could be set up legally as a trust, Non-Profit Company (NPC) or voluntary association (VA)). This highly preferential status exempts their income from tax provided that they undertake designated Public Benefit Activities, as listed in the 9th Schedule to the Income Tax Act (see Appendix 1) and meet various other (primarily compliance-related) requirements.

The number of PBOs approved by SARS is estimated to be approximately 50,000 (Davis, 2018).

The treatment of PBOs reflects a conceptual distinction between public benefit activities and activities that are aimed to generate a private benefit in the form of wages and profits. The 9th Schedule attempts to list these public benefit activities. That list generally consists of straightforwardly charitable activities in which the cost is clearly borne by one party and the benefit by another. In this conceptual distinction, investing is seen

as an activity generating private benefits. The idea that investing might at the same time generate positive public benefits has not been considered.

Despite the substantial (and largely favourable) changes to the taxation of non-profits ushered in since the early 2000s, there have long been calls for further revisions. Most notably, and following a public participation process, the Davis Committee, which sat between 2013 and 2018, received submissions and made further recommendations on enhancing the PBO regime. These recommendations covered areas such as:

- The burden of compliance placed upon non-profit entities by various laws, which places substantial cost pressures on those organisations that are often least financially able to meet such requirements (yet somehow manage to, typically to the detriment of their programmatic work).
- Discrepancies in the wording of the 9th Schedule, and the need for two parts to this schedule.
- The lack of promulgated regulations pertaining to the granting of loans.
- The exemptions pertaining to “trading” income by a non-profit entity and the interpretation of these provisions.
- The requirement to distribute 50% of donations received by the end of the succeeding tax year, per section 18A.

In addition to the DTC's recommendations, research into PBOs by academics over the past decade has raised a number of recommendations for changes, often in similar areas to the topics listed above.

More recently (between 2022 and 2024), various proposals for legislative and regulatory amendments to the income tax rules affecting PBOs have been submitted to National Treasury as part of the annual “Annexure C” process, by organisations such as the Banking Association South Africa, FirstRand Bank and Impact Investing South Africa.

What has spurred these calls for changes, from a widely diverse set of organisations?

As noted earlier, the financial environment in which many non-profits operate has deteriorated, with real pressure being exerted on donor budgets (including government budgets), leading non-profits to explore options for raising alternative sources of revenue. There are also non-profit entities (such as the B-BBEE foundations) that are seeking to deploy an element of their endowments more “actively” as impact investments, instead of earning a traditional passive return. Third, there is (and following a growing international trend and as shown in the diagram on page 10) an interesting intersection of philanthropic capital and capital from asset managers collaborating to test hybrid structures that seek a “blend” of both positive social or environmental and financial returns.

In all three instances the developers and participants are often forced to operate on the periphery of the existing PBO regime in order to develop and test their models and structures. The investor (or the non-profit) will “face a regulatory system that ignores the social good” of such alternative revenue sources or such experiments with impact investing, or treats it with suspicion (Bugg-Levine & Emerson, 2011).

Tax practitioners brought in to advise on these alternatives often recommend a “safe” course for clients who are seeking to develop new investment structures that direct private capital into socially beneficial ventures and initiatives. This caution stems from an understandable reluctance to jeopardise the special tax exempt status of their clients. Why risk losing the tax exemption on your income for the sake of an experiment that may raise you some marginal income, or raise no income at all? That such clients are seeking to do more than passive investing by supporting small business growth and employment creation, for example, or who are seeking to create new sustainable forms of revenue that may extend their longevity and reach into the communities they serve, does not seem to justify the risk.

From its perspective, SARS notes that being granted tax-exempt status carries with it a special responsibility not to abuse that status, nor to use it to create unfair competition with taxpaying entities and distort the market. In South Africa's revenue-constrained environment, these are valid concerns for the revenue authority. The withdrawal of the s12J investment incentive system, which aimed to stimulate investment in

start-up and high-growth companies, is a valuable lesson of how a well-intentioned tax incentive can be abused and SARS is correct to raise such concerns.

However, as this paper argues, the operating model upon which the current PBO regime is based sees non-profit entities functioning essentially as providers of services to communities using funds gathered from donations by well-meaning individuals and companies. Alternatively, the PBO has an already established endowment that is invested in "well-understood" public market assets generating a predictable but passive income for the entity to either spend on its programmes or to donate to another non-profit that will deliver a particular programme. This model – while still relevant in many parts of the non-profit sector – now has more nuance, brought about by the emergence and potential of impact investing and the desire of commercial and philanthropic investors who wish to use their capital collaboratively towards blended returns of social and financial outcomes.

In a country with such stark inequality, crippling poverty, growing levels of unemployment and ever-growing dependence on a revenue-constrained fiscus for grants, initiatives that can encourage financial sustainability for non-profits, and channel existing capital into new forms of impact-orientated investments that enhance social benefits, should be encouraged by the tax system, not be constrained by it.

Types of entity: legal versus taxpayer

The non-profit sector in South Africa is broadly governed by four primary pieces of legislation – the Non-Profit Organisations Act, the Companies Act, the Trust Property Control Act and the Income Tax Act. As a result, terminology drawn from these pieces of legislation is often used interchangeably and this can create confusion, particularly in respect of the type of entity. We provide below a brief overview of the key legal entity types and the types of taxpayer that are relevant to this paper.

When promulgated in 2008 the Companies Act created a new type of legal entity under section 8, namely a non-profit company (NPC), in contrast to the more typical "for profit" company (South Africa, 2008). A section 8 NPC replaced the company limited by guarantee concept from the previous Companies Act. An NPC may have members (or shareholders) or it may be incorporated without members in which case its powers and operations are governed by the terms of its founding document or memorandum of incorporation (MOI), which must contain at least one public benefit object. The key feature of a non-profit company is that no one is permitted to generate a profit from it, not that the company itself cannot generate a profit. There is, therefore, a distribution constraint in that members or owners cannot appropriate any surplus from the company. In all other respects the company operates as a normal company that will be taxed on any profits, unless it obtains further registration as a PBO.

Trusts have existed under South African law for decades (being inherited from English law, and which combine elements of Roman-Dutch and South African law) and are primarily governed by the Trust Property Control Act which forms the framework within which all trusts must operate (South Africa, 1988). A trust is an extremely flexible entity, with its objects and operating provisions set out in a trust deed. A trust is an entity which is created to hold assets for the benefit of certain persons or entities. It is not a juristic (legal) person like a company but there are times when, in terms of certain laws, a trust is regarded as having a separate legal personality, such as in terms of the Income Tax Act.

Under common law, a third type of entity is known as a voluntary association of persons brought together under a common purpose, typically three or more and bound together under a document/statement of common purpose/constitution. A voluntary association is typically the least formal of all these types of "entity", though often the most prevalent within many communities in this country.

The Non-Profit Organisations Act (NPO) is primarily applicable to any non-profit entity that wishes to register with the Department of Social Development (DSD); such registration is not compulsory unless the entity wishes to apply for grants provided by the DSD or if the entity provides funding to entities or individuals outside South Africa. The type of legal entity making the application to the DSD is not prescribed and could

be a trust, a non-profit company or a voluntary association of persons (*Nonprofit Organisations Act No. 71 of 1997, 1997*).

This paper uses the term non-profit entity as an umbrella term to describe organisations that may operate under the legal banner of a company, a trust or a voluntary association, whether registered as an NPO or not.

The taxation of non-profit entities is separate from both the legal entity type and NPO status as discussed above and is determined by the Income Tax Act (ITA). In this regard, the ITA provides favourable tax treatment for two types of taxpayer: a Public Benefit Organisation (PBO) and a Small Business Funding Entity (SBFE) (South Africa, 1962).

In other words, regardless of the type of legal entity and whether it is registered with the DSD or not, the entity may apply to register as a PBO with SARS in order to gain preferential tax treatment. Upon application, SARS will apply the requirements of the Income Tax Act to determine whether the entity qualifies as a PBO. If the entity meets the criteria set out in the ITA (or takes steps to do so within a reasonable time), SARS must approve the entity as a PBO and, accordingly, the income of the entity will be exempt from normal taxation (in most circumstances).

Furthermore, in recent years the ITA has introduced another type of taxpayer known as the Small Business Funding Entity (SBFE). While there are some parallels with PBOs, the SBFE has its own specific tax rules and requirements, some of which are relevant to the discussion on impact investing and will be referenced later in this paper.

In conclusion, it is evident that the taxation requirements for non-profit entities are largely agnostic of the type of legal entity concerned.

While concerns have been raised in the past in academic publications and the formal tax commissions about the compliance burden that registration with multiple regulatory bodies places on non-profit entities, such as with the DSD, CIPC and SARS, this high degree of resultant compliance is not a direct concern from an impact investing perspective and is not considered further in this report.

Overview of relevant sections of the Income Tax Act

This overview of the key sections of the Income Tax Act as applicable to non-profit entities is not intended to be exhaustive. For a full list of actual sections please see the SARS Basic Guide to Income Tax Exemption for Public Benefit Organisations. We also cover briefly the Small Business Funding Entity (SBFE), as this type of taxpayer has the potential to play a significant role in the growth in funding of small, medium and micro businesses. We refer to several tax types in the sections that follow, but the discussion will not cover employment taxes as these are unlikely to relate to the impact investing activities of a non-profit entity. We also do not cover the VAT Act, which provides a benefit to PBOs that register as a welfare organisation for VAT purposes of being able to claim back the VAT they incur as input tax (South Africa, 1991).

The requirements to become a Public Benefit Organisation - Section 30

Section 30 of the Income Tax Act is the primary section dealing with the taxation requirements for PBOs. Other relevant sections are section 10(1)(cN) which provides for the exemptions from normal tax for approved PBOs, and section 18A that deals with donations to approved PBOs.

The terms “public benefit organisation” and “public benefit activity” are contained in section 30(1) and it is the alignment of the core purpose or main object of a non-profit entity with these terms that gives rise to its qualification as a PBO and the special tax treatment afforded.

To qualify as a PBO, the public benefit activities that a non-profit entity undertakes must fall into one or more categories listed in the 9th Schedule to the ITA (South Africa, 1962). See Annexure 1 for the full list but in short these are:

- Welfare and Humanitarian (paragraph 1)
- Health Care (paragraph 2)
- Land and Housing (paragraph 3)
- Education and Development (paragraph 4)
- Religion, Belief or Philosophy (paragraph 5)
- Cultural (paragraph 6)
- Conservation, Environment and Animal Welfare (paragraph 7)
- Research and Consumer Rights (paragraph 8)
- Sport (paragraph 9)
- Providing of Funds, Assets and Other Resources (paragraph 10)

Each of these paragraphs contains examples of the activities SARS understands as falling within the broad headings.

There is a further “umbrella” option under paragraph 11 designed to cover support provided to foreign tax-exempt entities, the hosting of international events, the promotion, monitoring or reporting of development assistance for the poor and needy and the provision of support services to, or promotion of the common interests of, public benefit organisations contemplated in section 30 which conduct PBAs

An approved PBO may either conduct one or more approved PBAs or it may act as a conduit of funds, assets or other resources to enable other approved PBOs, voluntary associations or arms of government to carry on the specific activities listed in the 9th Schedule. This latter type is commonly referred to as a Conduit PBO. An example of a Conduit PBO would be a foundation that has an endowment and, rather than running its own programmes in communities, it provides grants to other approved PBOs that actually conduct the on-the-ground programme delivery work.

The long list of PBAs in the 9th Schedule, while seemingly comprehensive (70 activities are listed in Part I), has been described as “manifestly imperfect” (Davis, 2018) because, in a highly diverse society with its plethora of social challenges, there is simply no way in which every conceivable type of charitable activity that has a public benefit can be defined by legislation or added by regulation. Commentators have further pointed out that numerous anomalies arise from this list both by “inclusion and omission” (Davis, 2018).

The 9th Schedule also includes a second list (known as Part II with 48 listed activities), which contains a smaller list of public benefit activities which, if an organisation undertakes them, will allow it to be granted Section 18A status and which will then allow donations made to the PBO by third parties to be tax deductible by the donor. Again, various commentators including the Davis committee have suggested that the structure of the list and the activities it excludes (relative to Part I) should be re-examined.

An organisation wishing to apply for PBO status needs to have specific wording included in its founding documents (typically this will be the key objects clause) to link to the items listed in the 9th Schedule of PBAs.

Furthermore, the manner in which the organisation operates is key to SARS granting approval – emphasis here is placed on operating with a philanthropic and altruistic intent. “The intention of an organisation in carrying on any PBA may not be to generate a profit or financial return. An organisation carrying on a PBA as part of a profit-making venture will not qualify for approval as a PBO... Altruism generally means a concern for the well-being of others with no thought about oneself. Altruism is the opposite of self-interest.

The intention of an organisation must not be to carry on any PBA for the personal profit, benefit or advantage of the organisation to the exclusion or regard of the well-being of the general public." (South African Revenue Service, 2014)

The exemption from normal tax – Section 10(1) (cN)

Section 10(1) c(N) provides the legislative basis for the exemption from normal tax (and other taxes, such as dividends withholding tax, capital gains tax, transfer duty and estate duty) enjoyed by an approved PBO, as well as the rules for business or trading activity conducted by the PBO, the so-called partial taxation regime (South Africa, 1962).

With its core purpose established and linked to one or more PBAs, the ITA does recognise that a public benefit organisation may earn additional income from sources beyond donations. This includes passive income (such as interest on positive bank balances), dividends from investments (which in the hands of a PBO are exempt from dividend withholding tax), occasional trade (such as an annual fundraiser event) and also from business or trading income, provided it meets the requirement that the business undertaking or trading activity:

- Is integral and directly related to the sole or principal object for which the PBO is established, namely, to conduct one or more PBAs;
- Must be carried out or conducted on the basis substantially, the whole of which is directed towards the cost-recovery basis; and
- Does not result in unfair competition in relation to taxable entities.

If the PBO earns business or trade income that falls outside these categories it may then be taxed, but only if such income exceeds the greater of R200,000 or 5% of total receipts and accruals of the PBO in the year. Hence for example if the PBO earns R20m from all receipts and accruals in a year, then the threshold would be R1m (5% of R20m), and it would only be business income in excess of this R1m that would be taxed. The income above these limits would then be taxed at a flat rate of 28%, regardless of whether the PBO is a company or a trust. This rate is considerably lower than the standard rate of tax paid by a trust, for example, which is 45%.

For most traditional non-profit entities that are PBOs that "remain in their lane" and conduct their PBAs with no or limited instances of business or trading income, these rules and provisions provide sufficient cover for no tax to be paid, or at worst, only a limited amount of income tax.

However, if a non-profit entity is seeking to use its expertise to diversify its income base, or seeking to deploy some of its endowment capital into a bespoke investment structure with the possibility of generating a social and a financial return, it is the interpretation of these requirements that presents the biggest consequence for impact investing. This is considered in more detail in the "issues" section below.

Donations to a PBO – Section 18A

Section 18A governs the deductibility of donations made to an approved PBO which conducts approved PBAs listed in Part II of the 9th Schedule (and to bodies such as government or local authorities) (South Africa, 1962). Section 18A imposes various requirements on the donee (the non-profit entity receiving the donation), in terms of use of such funds (must be used to deliver or execute the PBA) and its reporting responsibilities (which include the issuing of s18A receipts to the donor). Section 18A has particular bearing on the ability of a PBO, specifically a Conduit PBO, to build up endowment assets using donations made to it and thus is relevant to impact investing.

The donation to a PBO, in terms of Section 18A(1), must be “bona fide” and may be in cash or of property made in kind (Oberholzer, 2004). . There is an extensive body of literature and case law on donations in South Africa and the concept is generally well-understood by practitioners, albeit that some uncertainties do exist, for example in valuing donations in kind (Nel & Klopper, 2019). This analysis will not look at the finer interpretations of donations and case law, suffice to say that a key element of any donation is that the donor may not have an expectation of a reciprocal benefit arising as a result of making the donation .

Section 18A does make an interesting distinction between a normal, activity-based PBO and a Conduit PBO regarding the use of the donation (if it is in cash). Section 18A(2A)(b) in the case of a Conduit PBO, notes that the Conduit PBO “will, within 12 months after the end of the relevant year of assessment, distribute or incur the obligation to distribute at least 50% of all funds received by way of donation during that year in respect of which receipts were issued.” (South Africa, 1962)

This imposes a requirement on the Conduit PBO to make regular and ongoing distributions to the PBOs it has partnered with and provides funds to. There is an assumption that the Conduit PBO either has a permanent source of funds (such as from a large endowment) or is able to constantly fund raise itself, in order to pass on such monies raised. It is not therefore possible for a Conduit PBO to build up an endowment with more than 50% of the funds raised by way of donations under this section, although it is technically possible for SARS to waive this obligation upon application, having regard to “the public interest and the purpose for which the relevant organisation wishes to accumulate those funds” (South Africa, 1962).

For any donated amounts not distributed but invested (e.g. in an interest earning account) by a Conduit PBO per the above, it is further required under Section 18A (2D) to distribute the income arising from such investments at least once every five years. The disposal of any investments is not subject to this requirement, with the expectation being that the proceeds would be used for reinvestment (for example if the investment was made in shares).

An “operating” PBO is not subject to these distribution requirements.

From this discussion the general expectation is that a received donation will be used for the specific PBA (or to run the entity) within a short space of time. In the case of a traditional non-profit entity, the proceeds from donations received in any year will be applied towards its core purpose – the relevant PBA – and to cover operational expenditure. The entity may swing from surplus to deficit on a year to year basis; and the legislation assumes the entity will always be able to raise more funds from donors. While it is possible under the Income Tax Act for an “operating” or delivery PBO to build up an endowment (for example, a rainy-day fund), in practice doing so has the perverse effect of discouraging donors; having a weak balance sheet increases the perception of need. The perverse impact of operating in a perpetually weak financial position for many non-profit entities is that if donor funding does dry up (or is reduced) they will not have the financial reserves to sustain their operations and continue to provide the benefits to the communities they serve. Given the crucial role non-profit entities play in South African society, this cannot be in the public interest.

Small Business Funding Entities – Section 30C

An SBFE is a relatively new type of taxpayer, introduced into the Income Tax Act in 2015. Much like a PBO and sharing many of the setup and ongoing compliance requirements of a PBO, an SBFE's activities are however restricted by law to the provision of funding for small, medium and micro-sized enterprises (SMMEs) (South Africa, 1962). (A PBO by contrast will perform one or more of the activities described above, as listed in the 9th Schedule). SMMEs will qualify for funding from an SBFE if:

- They meet the definition of micro business with turnover of less than R1m or
- They meet the definition of Small Business Corporation with gross income of less than R20m.

There are other structural requirements for both of these which need to be satisfied however it is not a requirement that the SMME concerned be registered with SARS as a micro business or SBC, merely that they meet the same criteria.

This funding provided by the SBFE must be widely accessible to SMMEs and must be provided with an altruistic or philanthropic intent – in other words on a not-for profit basis. As with a PBO, substantially the whole of the activities of the SBFE must be directed towards the provision of funding, meaning that there is limited scope to conduct other business activities. If such business or trading activities are performed, these will then need to be assessed under a similar set of partial taxation rules (South African Revenue Service, xxxx).

This implies that the SBFE is intended (from an income tax perspective) to raise funds either through donations or passively from investment assets (such as dividends on investment shares, or interest on cash balances), and then provide grant funding to qualifying SMMEs. It is not intended that the SBFE would provide interest-bearing loans, though there are reported instances where dispensation has been granted by SARS to permit this. Interest-free loans may be granted.

A small business that receives grant funding from an SBFE is able to treat this funding as tax-exempt income. Where it receives a loan instead of a grant, this would be booked as such on its balance sheet.

An SBFE will – as with a PBO – be exempt from capital gains tax, donations tax and dividends withholding tax, although some of these exemptions may require the satisfaction of certain additional compliance requirements. Unlike a PBO, however, an SBFE is not exempt from transfer duty and there is no estate duty benefit from a bequest made to an SBFE. A donation made to an SBFE is not deductible under Section 18A.

An SBFE is able to build up reserves from the funds it receives and from its income, as it is required to distribute only 25% of its annual income within a 12-month period from the end of the preceding financial year (South African Revenue Service, 2024). Thus an SBFE appears to have more flexible distribution requirements than a Conduit PBO, even though its function (from a societal perspective) is arguably very similar.

Conclusion

From this overview of the current tax legislation as applicable to non-profit entities in South Africa, the legislation is premised upon a basic distinction between a funded/operating PBO – one that relies primarily on annual donations for its public benefit activities and operations – and a funding PBO – one that has an existing endowment of investment assets that enables it to either 1) conduct its own public benefit activities directly (such as a family office or an empowerment foundation); or 2) pass on its funds to other PBOs (by way of donation) to allow them to conduct their public benefit work. Similarly SBFEs, with their highly prescribed purpose, are also treated as having either a fund-raising or a funding model.

The simple delineation of how a non-profit entity “should” operate is becoming less appropriate. The world of impact investing – with its array of different investing instruments and methods – is bringing the current limits of the PBO and SBFE taxation regime into sharp focus. The issues arising from such methods and instruments and the limitations of the current legislation are explored in the next section.

Issues arising from the research

The issues raised below are based on a review of various academic papers, reports from industry bodies, matters raised by the Davis committee and the experience of tax practitioners and foundations who have provided stakeholder input into this research paper. At this point in the research process they have not been

grouped or arranged thematically, but this may be done in the final presentation of the research findings once input from stakeholders has been received.

1. Public Benefit Activities listed in the 9th Schedule

As noted above the list of approved Public Benefit Activities in the 9th Schedule, while seemingly comprehensive, has been described as “susceptible to error and omission” (Davis, 2018) because, in a highly diverse society with its plethora of social challenges, there is simply no way in which every conceivable type of charitable activity that has a public benefit can be defined by legislation or added by regulation. Numerous anomalies arise from this list, by virtue of its structure and wording. While the list does get and has been amended periodically, SARS itself confirms that a subjective interpretation of objective facts is necessary to assess whether a prospective non-profit entity will qualify for PBO status (South African Revenue Service, 2014).

Paradoxically, applicants often directly copy the wording from the 9th Schedule into their founding documents in the hope that this will secure a more favourable review; yet this has the potential to encourage entities that deliver novel solutions to pressing social challenges to obscure the true nature of their work from SARS, for the sake of securing PBO status. This cannot be a desirable outcome.

The 9th Schedule also includes a second list (known as Part II), which contains a smaller list of public benefit activities (the list mirrors the first five sections of Part I; refer to Annexure 1). If an organisation undertakes activities in this list, this will allow it to be granted s18A status and which will then allow donations made to the PBO by third parties to be tax deductible. Again, various commentators have suggested that the structure of the list and the activities it excludes be re-examined, with one suggestion being that both lists simply be consolidated to improve administrative efficiency and understanding and allow more activities to qualify for s18A donations.

2. Section 10(1) (cN) and partial taxation rules

Numerous studies and reports have highlighted the issues with the interpretation of the partial taxation regime, both conceptually and with respect to the thresholds that have remained unchanged for many years. See for example (Lestrade, 2002), (Rice, 2018) and Davis, 2018.

Let's take an impact investor – say a corporate foundation – wishing to diversify some of its investment portfolio and “do more” with a small portion of its assets, such as 5%. Even a small move of endowment assets into a more actively structured portfolio could be regarded as no longer generating “passive” income. And while the returns would be taxed only if they exceed the 5%/R200,000 limit, the danger is that such activities may be deemed by SARS to no longer be “core” and could result in the PBO losing its tax exempt status.

Yet in the current investing climate, many endowments are seeking to better align how they invest with their core purpose – with what they do. The diagram on page 10 depicts this shift in sentiment. The ability for some portion of an endowment to be “mission aligned” and placed into businesses or other investment vehicles (such as a loan structure that provides concessional debt to a group of small businesses) may well fall foul of the “core purpose” rules, even if any financial returns were to be reinvested by the non-profit concerned, and if the ultimate purpose of the investments was to achieve the public benefits that are core.

Equally, for a PBO that wishes to diversify its revenue sources to protect itself from fluctuations in or a loss of donations, for example by offering its expertise and services to other foundations, such a move carries high risk as SARS may view this as a “loss of focus” from its core purpose even though this would be done to strengthen financial resources and the long-term viability of its core purpose.

Given the significant role in society played by many non-profit entities, the dated monetary threshold (5%/R200,000, last amended in 2011) and restrictive interpretation of the partial taxation rules in both sets of

examples are hindering both the financial sustainability of many non-profit entities and the development of impact investing initiatives that could channel a portion of passively held investment funds into social impact-type structures

3. Section 18A

While the 50% distribution requirement discussed above has been relaxed (it was previously 75%), there is an anomaly with the SBF's (more recent) 25% distribution requirement as both seek to achieve a similar public good. In a similar vein, the 50% distribution rule makes it very difficult for like-minded impact investors to work together establish an endowment from scratch for a new PBO (by collectively contributing funds towards its establishment from donations made over a period of time, such as over a period of ten years).

While section 18A gives the SARS Commissioner the ability to waive the 50% distribution requirement, no grounds are given as to why the Commissioner may do so (or decline to do so) other than the public interest, and this creates uncertainty for potential impact investors.

Similarly, the 5-year distribution rule on investment income earned from non-distributed donations (per section 18A (2D)), not only creates an administrative burden for PBOs to track and time all such income earned within five yearly cycles, but it also removes the ability of a PBO to reinvest or simply retain (as reserves) such income when it may be financially prudent and beneficial to do so. Effectively forcing a PBO to distribute such monies could be viewed as overly paternalistic and deprives the PBO of the ability to judge when and how to adapt and adjust its investment strategy based on prevailing circumstances.

4. Regulations for loans

The 9th Schedule (both Part I and Part II) under the section for Welfare and Humanitarian activities, makes provision for community development support for the poor and needy and anti-poverty initiatives, including under subsection (p)(iii):

“The provision of training, support or assistance to emerging micro enterprises to improve capacity to start and manage businesses which may include the granting of loans on such conditions as may be prescribed by the Minister by way of regulation.”(South Africa, 1962)

The regulations for the granting of loans under p(iii) have never been published by the Minister of Finance, more than 20 years after the introduction of this part of the 9th Schedule. Apparently attempts have been made by some financial institutions to prepare the wording of possible draft regulations and discuss these with National Treasury, in order to be able to set up small and micro business lending vehicles and apply for PBO status using this particular PBA. Several commentators have suggested that were these regulations to be published, they would likely stimulate the provision of more funding to qualifying SMEs.

5. Overall approach to PBO regime

The legislative structuring of the PBO regime in South Africa as explored in this report is highly prescriptive. A good example of this approach is the listing of Public Benefit Activities in the 9th Schedule. It is important to acknowledge that the current PBO regime represents a significant improvement on that which existed and was dealt with by the Katz Commission in 1999. It is also important that the PBO system is not abused by unscrupulous taxpayers, and having a highly prescriptive approach can provide valuable clarity for non-profit entities seeking to establish and structure their operations to utilise available tax concessions.

However, in the two decades since the foundational premises of the current PBO regime were developed, much has changed in South Africa's broader socioeconomic context and the legislative and regulatory boundaries of these fundamental premises are being tested. Other tax jurisdictions are adapting to the opportunities presented by impact investing (see following section).

As was stated in the Davis committee report to the Minister of Finance: “The second advantage of private control ... lies in the effect of such control upon the overall pattern of our society. ... [T]he broad ramifications of freedom require a preference for private activity and diversity.” (Davis, 2018)

The core of the current PBO regime is largely sound; in this paper, we advocate for a greater degree of flexibility to cater for the diversity of approaches noted in the quote above. This flexibility is primarily needed to:

1. Enable revenue generation by non-profit entities to secure long-term financial and operational sustainability; and
2. Permit the deployment of endowment assets (or a portion thereof) into new and merging impact investment vehicles without the fear of a loss of PBO status and significant taxation arising from returns generated from such vehicles.

The above should be permitted on the grounds that substantially all (if not all) the proceeds and returns are dedicated to the operations and programmatic activities of the non-profit concerned. Given the legal entity status of many non-profit entities (ie, NPC or trust), such reinvestment is legally inherent and should be recognised as such by SARS.

Given the financial pressures facing many non-profit entities due to falling donations in a climate of low economic growth and fiscal austerity, providing such flexibility should not create public policy issues. Indeed, as was stated in the Davis committee report: “The organisations effectively ease the burden on the state with respect to the provisioning of key social and economic goods.”(Davis, 2018).

6. Small Business Funding Entity matters

Provision of forms of business support and concessionary loans to SMEs (as a form of impact investing) by SBFEs have a major role to play in filling the gap between early-stage business financing (grants-based) and commercial finance (eg, by banks). With the Section 12J Venture Capital Company regime having ended in 2021, it has become even more important to ensure that the SBFE regime functions optimally and is compatible and consistent with PBA 1(p)(iii) under the PBO regime (note 4 above on p(iii) refers).

The operating restrictions on an SBFE based upon the wording in Section 30C create the impression that such an entity may only provide funding to a SMME, not other types of support. In reality the provision of funding (eg, by way of grant) is often intertwined with the simultaneous provision of business support services. Such services typically consist of mentoring, advice, access to incubator programmes and common shared work spaces to prototype ideas and business concepts. The lack of clarity on whether an SBFE is permitted to provide ancillary services such as business support, mentoring and technical support to recipients of funding would enhance the operating capabilities of SBFEs and remove the risk of jeopardising their SBFE tax status by providing a combination of both funding and business support.

The tax premise of SBFE funding is that the funding provided to SMMEs is either in the form of grants or interest-free loans. This type of funding is often used in the early stages of a business's growth. Yet businesses do also seek interest-bearing debt and equity funding as they grow and mature, but the regulations do not envisage the SBFE being able to provide alternative forms of finance (even though it may have the infrastructure and the financial resources to do so). The expectation in the tax design is that such businesses would graduate to banks or other providers of commercial finance. Yet the “funding gap” for small, growing businesses remains. The SBFE regime could provide a valuable source of small business funding to help fill this gap. The world of impact investing is creating new forms of financial instrument, such as convertible debt, revenue-based debt and grants-to-equity agreements. These instruments are often more favourably structured for SMMEs as they offer less restrictions and more flexibility to adapt to unpredictable business events than traditional debt or equity instruments.

The Income Tax Act contains special tax dispensations for small businesses themselves: these are the micro business and the Small Business Corporation. The Income Tax Act definitions of micro business and Small

Business Corporation however only permit natural persons to be shareholders in such businesses. Hence even if it wanted to, an SBFE could not provide equity capital (or funding that in time and based on various events converts to equity capital) to a microbusiness or an SBC.

An SBFE would only be able to make an equity investment to a “medium-sized” business or one that was not formally registered with SARS as a micro business or as an SBC. Once again, the emerging world of impact investing is highlighting the well-intentioned definitions of microbusiness and SBC in the Income Tax Act create obstacles to such enterprises benefiting from investors using a SBFE to provide more flexible forms of financing to support business growth.

International examples

The table below highlights selected countries that have adapted their taxation regimes around non-profit organisations to encourage impact investing, and/or have gone further in recognising a new type of business entity, known as a social enterprise, that enjoys special tax status. The table highlights the key concession aspects applicable in each country. Please refer to the 2021 report published by Impact Investing South Africa for more detailed information and explanations relevant to each country listed below (Hare et al., 2021).

Country	Description of tax benefit
Thailand	<p>Thailand has both profit-sharing and non-profit-sharing social enterprises: this is a separate status which is conferred upon qualifying companies rather than being a separate form of legal entity.</p> <p>Profit generating investments are permitted, but any profits will need to be wholly or partly reinvested in the company in pursuit of its specific social purpose.</p>
Vietnam	<p>Vietnam has a social enterprise concept which is its own, separate legal form of entity, to address social and environmental issues for the public benefit.</p> <p>Profit-making from business or trading activities is permitted provided that at least 51% of the total annual profit is reinvested in the entity's core social or environmental objectives.</p> <p>Interestingly, eligibility for tax benefits (being exemptions and deductions) is determined with reference to the type of income received, and type of expenses incurred – not the type of entity receiving or incurring such income or expense.</p>
India	<p>Non-profit entities in India can invest in specific kinds of shares and financial instruments, but all profits from these investments need to be applied fully towards the core philanthropic objective/s of the non-profit.</p> <p>There is a cap on business or trading income undertaken by non-profit entities; this cap is set at 20% of the total income of the non-profit (in South Africa this cap is 5% of R200,000 whichever is the greater).</p> <p>Furthermore, a non-profit may invest its surplus funds (presumably with the intention of either building an endowment or diversifying income, or both), but again profits must be reinvested back into the core philanthropic activities.</p>
South Korea	<p>The law in South Korea recognises the concept of a social enterprise which is regarded as a “status” as opposed to a separate legal form.</p>

	<p>A social enterprise must engage in certain business activities and pursue certain social purposes, and spend at least two-thirds of its profits on its social purpose. This model is an illustration of a "hybrid" type of enterprise (which is common in impact investing discussions) that pursue a social purpose and (at some point) a profit.</p> <p>There are various tax deductions for connected enterprises providing support to social enterprises (the commentary on SBFs in South Africa raises issues in this regard), which is a potentially useful model to consider for the expansion of the South African SBF regime.</p>
UK	<p>Charities in the UK are allowed to make tax-exempt social investments provided these support the charity's activities and include achieving a financial return.</p> <p>Furthermore, the Social Investment Tax Relief Scheme introduced in 2014 gives individuals who invest in "qualified social enterprises" an income tax deduction equal to 30% of the amount invested. Various associated CGT benefits are also available.</p> <p>Such deductions would have the effect of stimulating a wider and more ambitious form of "giving" into social enterprises, recognising the valuable role they play in UK society.</p>
USA	<p>The USA has perhaps the most wide-ranging and sophisticated arrangements for special taxpayer types and associated benefits for impact investing. For example:</p> <ul style="list-style-type: none"> • 501(c)(3) non-profit entities may make passive, return-generating investments, but must ensure that any such returns are used to reinvest in the entity. • The tax code permits tax-exempt foundations to make programme-related investments (such as loans, loan guarantees and equity investments in certain circumstances) in furtherance of their primary, philanthropic purpose. • The for-profit "benefit corporation" (B-Corp) has a primary profit-making purpose but is set up for activities that have a social purpose. A B-Corp has to have its activities independently certified. • In California, the "flexible purpose corporation" (which has similarities to the B-Corp, has to select a specific social mission or purpose to pursue in its profit-making ventures.

Finally, note that in late 2024, Japan permitted the national public sector pension fund (equivalent to South Africa's GEPP) to begin to direct a portion of its funds under management into impact investing projects. Clearly such funds will expect a financial return, even a modest one, but there is an implicit belief that such investments will also generate a valuable social return as well.

Initial policy recommendations for South Africa

As has been highlighted in this report, the taxation regime for PBOs in South Africa does not require wholesale revision along the lines of that proposed by the Katz Commission in 1999 to facilitate greater levels of impact investing. What is necessary however is to take steps to resolve the ambiguity around impact investing and alternative revenue generation, by non-profit entities. As the example from Japan cited above illustrates, there are clear, obvious public benefits to allowing more funding to flow into the non-profit sector than merely in the form of sometimes volatile donations, and the taxation regime needs to adapt to this.

It is well recognised that the state has challenges in service delivery and should therefore “view the service organisations as resources in the restructuring of the South African social service delivery system” (Boshoff & Engelbrecht, 2016). Accordingly, impact investing under a clearer and more conducive tax regime for PBOs can be the approach to redirect financial assets into the social sector, thereby alleviating the significant financial grant burden placed upon the state to help meet the basic needs of the indigent.

The underlying premise of how funding flows (or should flow) into the non-profit sector, and what such entities do with this funding, as manifested in sections 30, 18A and 10(1)(cN) and in the 9th Schedule of the Income Tax Act, present challenges for a) those philanthropic organisations with endowment funds to invest (mission- aligned investing) or spend their money in ways other than grants (programme-aligned investing); and b) for those philanthropic organisations that wish to build up endowments as a cushion against future fluctuations in funding, or use their skills and resources to earn alternative revenue streams to ensure the financial futures of their operations.

These recommendations will be refined further based upon input received from the stakeholder engagement process as part of Phase 2 of this project.

It is interesting that Schedule 1 of the Companies Act (sub-section 2) clearly permits a non-profit company to “hold securities issued by a profit company” or “directly or indirectly ... carry on any business, trade or undertaking consistent with or ancillary to its stated object” (South Africa, 2008). This is wording that the ITA seeks to restrict in the event of an NPC seeking to be granted PBO status.

The overall thrust of the recommendations that follow is therefore to permit greater flexibility from the tax regulations in respect of impact investing.

- a. Increase the thresholds for business or trading activities to R500,000 or 20% of receipts and accruals in any year.
- b. Relax the current requirement for business or trading activities to be linked to the “core” purpose of the PBO, replacing this with a requirement for all profits made from such activities to be reinvested in furthering the mandate and objectives of the PBO.
- c. Align Part I and Part II of the 9th Schedule of the ITA and establish the working practice that the items listed in these parts are not a definitive list but rather offer guidance when making application to the Tax Exemption Unit for PBO status. This approach will also obviate the need for a lengthy ministerial and parliamentary approval process for new types of PBA to be considered and approved.
- d. Draft and promulgate the regulations for lending activities under Part 1 (1)(piii) and consider the extension of these to fields other than poverty alleviation, to enable a wider target set of beneficiaries of concessional lending, including small businesses. These regulations should be extended further to permit investing in SMMEs
- e. Further reduce the distribution requirement for a Conduit PBO in section 18A from 50% to 25% to align with the similar SBFE requirement and extend the period in which such distributions need to occur from 12 months to five years.
- f. Consider creating a new type of taxpayer – a “social enterprise”, as has been introduced in various other jurisdictions. Such an entity would operate as a “dual purpose” business: a profit-making enterprise but which is obliged to reinvest all (or a majority of) its profits into the business to further its core social purpose.
- g. Clarify that an SBFE may undertake a wider range of activities in addition to the provision of funds, such as business support, technical assistance and mentoring.
- h. Permit an SBFE to hold equity interests in its portfolio of beneficiaries, to cater for the new and emerging forms of financial instrument such as convertible grants and hybrid debt instruments that

can convert into equity. Expand the definition of eligible business that a SBFE can fund / provide support to from the existing SBC R20m limit to R50m for for-profit businesses and all social enterprises.

- i. Permit lending by non-natural persons to micro enterprises and Small Business Corporations to try to stimulate the uptake of these forms of special taxpayer. Give consideration to the transition mechanisms between these types of special taxpayer to a normal taxpaying company. This would enable new, hybrid forms of impact investing instruments (eg those that convert to equity) to be offered to micro-businesses and Small Business Corporations by an SBFE and permit the ongoing (supportive) financial relationship between such business and an SBFE.
- j. Consider presenting a more public face to the Tax Exemption Unit, such that the results of its work, and its approach is more visible to the impact investing, PBO and SBFE community. Cases of abuse, examples of unusual or complex cases and statistics, could all prove invaluable in the development of the impact investing market in South Africa.

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Annexure 1

9th Schedule list of Public Benefit Activities

9th SCHEDULE PART I

WELFARE AND HUMANITARIAN

1.
 - a. The care or counseling of, or the provision of education programmes relating to, abandoned, abused, neglected, orphaned or homeless children.
 - b. The care or counseling of poor and needy persons where more than 90 per cent of those persons to whom the care or counseling are provided are over the age of 60.
 - c. The care or counseling of, or the provision of education programmes relating to, physically or mentally abused and traumatized persons.
 - d. The provision of disaster relief.
 - e. The rescue or care of persons in distress.
 - f. The provision of poverty relief.
 - g. Rehabilitative care or counseling or education of prisoners, former prisoners and convicted offenders and persons awaiting trial.
 - h. The rehabilitation, care or counseling of persons addicted to a dependence-forming substance or the provision of preventative and education programmes regarding addiction to dependence-forming substances.
 - i. Conflict resolution, the promotion of reconciliation, mutual respect and tolerance between the various peoples of South Africa.
 - j. The promotion or advocacy of human rights and democracy.
 - k. The protection of the safety of the general public.
 - l. The promotion or protection of family stability.
 - m. The provision of legal services for poor and needy persons.
 - n. The provision of facilities for the protection and care of children under school-going age of poor and needy parents.
 - o. The promotion or protection of the rights and interests of, and the care of, asylum seekers and refugees.
 - p. Community development for poor and needy persons and anti-poverty initiatives, including—
 - i. the promotion of community-based projects relating to self-help, empowerment, capacity building, skills development or anti-poverty;
 - ii. the provision of training, support or assistance to community-based projects contemplated in item (i);
or

- iii. the provision of training, support or assistance to emerging micro enterprises to improve capacity to start and manage businesses, which may include the granting of loans on such conditions as may be prescribed by the Minister by way of regulation.
- q. The promotion of access to media and a free press.

HEALTH CARE

- 2.
 - a. The provision of health care services to poor and needy persons.
 - b. The care or counseling of terminally ill persons or persons with a severe physical or mental disability, and the counseling of their families in this regard.
 - c. The prevention of HIV infection, the provision of preventative and education programmes relating to HIV/AIDS.
 - d. The care, counseling or treatment of persons afflicted with HIV/AIDS, including the care or counseling of their families and dependants in this regard.
 - e. The provision of blood transfusion, organ donor or similar services.
 - f. The provision of primary health care education, sex education or family planning.

LAND AND HOUSING

- 3.
 - a. The development, construction, upgrading, conversion or procurement of housing units for the benefit of persons whose monthly household income is equal to or less than R15 000 or any greater amount determined by the Minister of Finance by notice in the Gazette after consultation with the Minister of Housing.
 - b. The development, servicing, upgrading or procurement of stands, or the provision of building materials, for purposes of the activities contemplated in subparagraph (a).
 - c. The provision of residential care for retired persons, where—
 - i. more than 90 per cent of the persons to whom the residential care is provided are over the age of 60 and nursing services are provided by the organisation carrying on such activity; and
 - ii. residential care for retired persons who are poor and needy is actively provided by that organisation without full recovery of cost.
 - d. Building and equipping of—
 - i. clinics or crèches; or
 - ii. community centres, sport facilities or other facilities of a similar nature,
for the benefit of the poor and needy.
 - e. The promotion, facilitation and support of access to land and use of land, housing and infrastructural development for promoting official land reform programmes.

- f. Granting of loans for purposes of subparagraph (a) or (b), and the provision of security or guarantees in respect of such loans, subject to such conditions as may be prescribed by the Minister by way of regulation.
- g. The protection, enforcement or improvement of the rights of poor and needy tenants, labour tenants or occupiers, to use or occupy land or housing.
- h. The provision of training, support or assistance to emerging farmers in order to improve capacity to start and manage agricultural operations.

EDUCATION AND DEVELOPMENT

4.

- a. The provision of education by a "school" as defined in the South African Schools Act, 1996, (Act No. 84 of 1996).
- b. The provision of "higher education" by a "higher education institution" as defined in terms of the Higher Education Act, 1997, (Act No. 101 of 1997).
- c. "Adult basic education", as envisaged in section 29 (1) (a) of the Constitution, including literacy and numeracy education.
- d. "Continuing education and training" provided by a "private college" as defined in the Continuing Education and Training Colleges Act, 2006 (Act No. 16 of 2006), which is registered in terms of that Act.
- e. Training for unemployed persons with the purpose of enabling them to obtain employment.
- f. The training or education of persons with a severe physical or mental disability.
- g. The provision of bridging courses to enable educationally disadvantaged persons to enter a higher education institution as envisaged in subparagraph (b).
- h. The provision of educare or early childhood development services for pre-school children.
- i. Training of persons employed in the national, provincial and local spheres of government, for purposes of capacity building in those spheres of government.
- j. The provision of school buildings or equipment for public schools and educational institutions engaged in public benefit activities contemplated in subparagraphs (a) to (h).
- k. Career guidance and counseling services provided to persons attending any school or higher education institution as envisaged in subparagraphs (a) and (b).
- l. The provision of hostel accommodation to students of a public benefit organisation contemplated in section 30 or an institution, board or body contemplated in section 10 (1) (cA) (i), carrying on activities envisaged in subparagraphs (a) to (g).
- m. Programmes addressing needs in education provision, learning, teaching, training, curriculum support, governance, whole school development, safety and security at schools, pre-schools or educational institutions as envisaged in subparagraphs (a) to (h).
- n. Educational enrichment, academic support, supplementary tuition or outreach programmes for the poor and needy.
- o. The provision of scholarships, bursaries, awards and loans for study, research and teaching on such conditions as may be prescribed by the Minister by way of regulation in the Gazette.

- p. The provision or promotion of educational programmes with respect to financial services and products, carried on under the auspices of a public entity listed under Schedule 3A of the Public Finance Management Act.
- q. The provision, to the general public, of education and training programmes and courses that are administered and accredited by entities contemplated in paragraph (r).
- r. The administration, provision and publication of qualification and certification services by industry organisations recognised by an industry specific organisation and its qualifications accredited by the Quality Council for Trades and Occupations established in 2010 in terms of the Skills Development Act, 1998 (Act No. 97 of 1998).

RELIGION, BELIEF OR PHILOSOPHY

- 5.
 - a. The promotion or practice of religion which encompasses acts of worship, witness, teaching and community service based on a belief in a deity.
 - b. The promotion and/or practice of a belief.
 - c. The promotion of, or engaging in, philosophical activities.

CULTURAL

- 6.
 - a. The advancement, promotion or preservation of the arts, culture or customs.
 - b. The promotion, establishment, protection, preservation or maintenance of areas, collections or buildings of historical or cultural interest, national monuments, national heritage sites, museums, including art galleries, archives and libraries.
 - c. The provision of youth leadership or development programmes.

CONSERVATION, ENVIRONMENT AND ANIMAL WELFARE

- 7.
 - a. Engaging in the conservation, rehabilitation or protection of the natural environment, including flora, fauna or the biosphere.
 - b. The care of animals, including the rehabilitation, or prevention of the ill-treatment of animals.
 - c. The promotion of, and education and training programmes relating to, environmental awareness, greening, clean-up or sustainable development projects.
 - d. The establishment and management of a transfrontier area, involving two or more countries, which—
 - i. is or will fall under a unified or coordinated system of management without compromising national sovereignty; and
 - ii. has been established with the explicit purpose of supporting the conservation of biological diversity, job creation, free movement of animals and tourists across the

international boundaries within the peace park, and the building of peace and understanding between the nations concerned.

RESEARCH AND CONSUMER RIGHTS

8.

- a. Research including agricultural, economic, educational, industrial, medical, political, social, scientific and technological research.
- b. The protection and promotion of consumer rights and the improvement of control and quality with regard to products or services.

SPORT

9.

The administration, development, co-ordination or promotion of sport or recreation in which the participants take part on a non-professional basis as a pastime.

PROVIDING OF FUNDS, ASSETS OR OTHER RESOURCES

10.

The provision of—

- a. funds, assets, services or other resources by way of donation;
- b. assets or other resources by way of sale for a consideration not exceeding the direct cost to the organisation providing the assets or resources;
- c. funds by way of loan at no charge; or
- d. assets by way of lease for an annual consideration not exceeding the direct cost to the organisation providing the asset divided by the total useful life of the asset,

to any—

- i. public benefit organisation which has been approved in terms of section 30;
- ii. institution, board or body contemplated in section 10 (1) (cA) (i), which conducts one or more public benefit activities in this part (other than this paragraph);
- iii. association of persons carrying on one or more public benefit activity contemplated in this part (other than this paragraph), in the Republic; or
- iv. department of state or administration in the national or provincial or local sphere of government of the Republic, contemplated in section 10 (1) (a).

GENERAL

- a. The provision of support services to, or promotion of the common interests of public benefit organisations contemplated in section 30 or institutions, boards or bodies contemplated in section 10 (1) (cA) (i), which conduct one or more public benefit activities contemplated in this part.

- b. The bid to host or hosting of any international event approved by the Minister for purposes of this paragraph, having regard to—
 - i. the foreign participation in that event; and
 - ii. the economic impact that event may have on the country as a whole.
- c. The promotion, monitoring or reporting of development assistance for the poor and needy.
- d. The provision of funds to an organisation—
 - i. which is incorporated, formed or established in any country other than the Republic;
 - ii. which is exempt from tax on income in that other country;
 - iii. the sole or principal object of which is the carrying on of one or more activities that would qualify as public benefit activities listed in Part I of this Schedule if carried on in the Republic; and
 - iv. that carries on each of its activities—
 - (aa) in a non-profit manner;
 - (bb) with altruistic or philanthropic intent;
 - (cc) in a manner which does not directly or indirectly promote the economic self-interest of any fiduciary or employee of the organisation other than by way of reasonable remuneration; and
 - (dd) for the benefit of, or is widely accessible to the general public of that country including any sector thereof (other than small and exclusive groups).

9th SCHEDULE PART II

WELFARE AND HUMANITARIAN

1.
 - a. The care or counseling of, or the provision of education programmes relating to, abandoned, abused, neglected, orphaned or homeless children.
 - b. The care or counseling of poor and needy persons where more than 90 per cent of those persons to whom the care or counseling are provided are over the age of 60.
 - c. The care or counseling of, or the provision of education programmes relating to, physically or mentally abused and traumatised persons.
 - d. The provision of disaster relief.
 - e. The rescue or care of persons in distress.
 - f. The provision of poverty relief.

- g. Rehabilitative care or counseling or education of prisoners, former prisoners and convicted offenders and persons awaiting trial.
- h. The rehabilitation, care or counseling of persons addicted to a dependence-forming substance or the provision of preventative and education programmes regarding addiction to dependence-forming substances.
- i. Conflict resolution, the promotion of reconciliation, mutual respect and tolerance between the various peoples of South Africa.
- j. The promotion or advocacy of human rights and democracy.
- k. The protection of the safety of the general public.
- l. The promotion or protection of family stability.
- m. The provision of legal services for poor and needy persons.
- n. The provision of facilities for the protection and care of children under school-going age of poor and needy parents.
- o. The promotion or protection of the rights and interests of, and the care of, asylum seekers and refugees.
- p. Community development for poor and needy persons and anti-poverty initiatives, including—
 - a) the promotion of community-based projects relating to self-help, empowerment, capacity building, skills development or anti-poverty;
 - b) the provision of training, support or assistance to community-based projects contemplated in item (i); or
 - c) the provision of training, support or assistance to emerging micro enterprises to improve capacity to start and manage businesses, which may include the granting of loans on such conditions as may be prescribed by the Minister by way of regulation.
- q. The promotion of access to media and a free press.

HEALTH CARE

- 2.
 - a. The provision of health care services to poor and needy persons.
 - b. The care or counseling of terminally ill persons or persons with a severe physical or mental disability, and the counseling of their families in this regard.
 - c. The prevention of HIV infection, the provision of preventative and education programmes relating to HIV/AIDS.
 - d. The care, counseling or treatment of persons afflicted with HIV/AIDS, including the care or counseling of their families and dependants in this regard.
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 - f. The provision of primary health care education, sex education or family planning.

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- 3.
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 - d. "Continuing education and training" provided by a "private college" as defined in the Continuing Education and Training Colleges Act, 2006 (Act No. 16 of 2006), which is registered in terms of that Act.
 - e. Training for unemployed persons with the purpose of enabling them to obtain employment.
 - f. The training or education of persons with a severe physical or mental disability.
 - g. The provision of bridging courses to enable educationally disadvantaged persons to enter a higher education institution as envisaged in subparagraph (b).
 - h. The provision of educare or early childhood development services for pre-school children.
 - i. The provision of school buildings or equipment for public schools and educational institutions engaged in public benefit activities contemplated in subparagraphs (a) to (h).
 - j. Programmes addressing needs in education provision, learning, teaching, training, curriculum support, governance, whole school development, safety and security at schools, pre-schools or educational institutions as envisaged in subparagraphs (a) to (h).
 - k. Educational enrichment, academic support, supplementary tuition or outreach programmes for the poor and needy.
 - l. Training of persons employed in the national, provincial and local spheres of government, for purposes of capacity building in those spheres of government.
 - m. Career guidance and counseling services provided to persons attending any school or higher education institution as envisaged in subparagraphs (a) and (b).
 - n. The provision of hostel accommodation to students of a public benefit organisation contemplated in section 30 or an institution, board or body contemplated in section 10 (1) (cA) (i), carrying on activities envisaged in subparagraphs (a) to (g).
 - o. The provision of scholarships, bursaries, awards and loans for study, research and teaching on such conditions as may be prescribed by the Minister by way of regulation in the Gazette.
 - p. The provision or promotion of educational programmes with respect to financial services and products, carried on under the auspices of a public entity listed under Schedule 3A of the Public Finance Management Act.

CONSERVATION, ENVIRONMENT AND ANIMAL WELFARE

- 4.
- a. Engaging in the conservation, rehabilitation or protection of the natural environment, including flora, fauna or the biosphere.
 - b. The care of animals, including the rehabilitation or prevention of the ill-treatment of animals.

- c. The promotion of, and education and training programmes relating to, environmental awareness, greening, clean-up or sustainable development projects.
- d. The establishment and management of a transfrontier area, involving two or more countries, which—
 - i. is or will fall under a unified or coordinated system of management without compromising national sovereignty; and
 - ii. has been established with the explicit purpose of supporting the conservation of biological diversity, job creation, free movement of animals and tourists across the international boundaries of the peace park, and the building of peace and understanding between the nations concerned.

LAND AND HOUSING

- 5.
 - a. The development, construction, upgrading, conversion or procurement of housing units for the benefit of persons whose monthly household income is equal to or less than R15 000 or any greater amount determined by the Minister of Finance by notice in the Gazette after consultation with the Minister of Housing.
 - b. The development, servicing, upgrading or procurement of stands, or the provision of building materials, for purposes of the activities contemplated in subparagraph (a).
 - c. Building and equipping of clinics or crèches for the benefit of the poor and needy.
 - d. The protection, enforcement or improvement of the rights of poor and needy tenants, labour tenants or occupiers, to use or occupy land or housing.
 - e. The promotion, facilitation and support of access to land and use of land, housing and infrastructural development for promoting official land reform programmes.