Track 2 Workshop

14 May 2025

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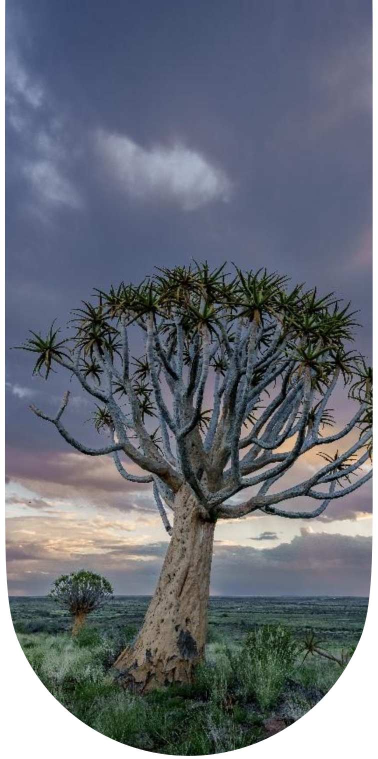
Agenda

1. Welcomes and introductions
2. Recap on Accelerating Impact project objectives and phases
3. Aims of Track 2
4. Issues emerging from the research phase
5. Recommendations
6. Concluding remarks



Setting the scene

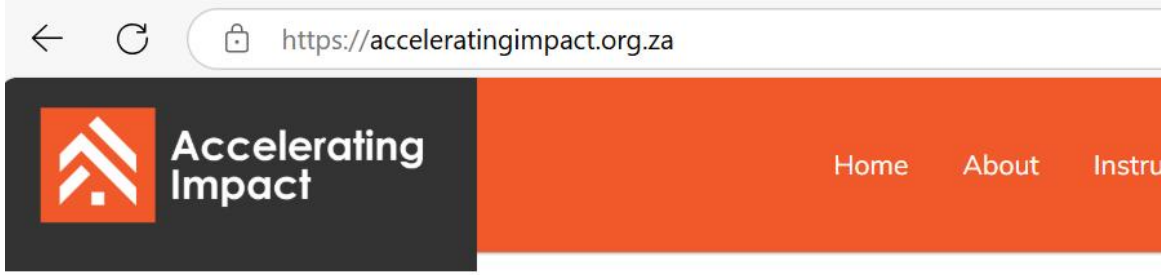
- "In most countries, regulations simply do not recognise and support the ambitions that social entrepreneurs and impact investors increasingly hold to create blended value though impact investments…
- …regulatory systems that force people to jump through hoops will stifle impact investment."[1]

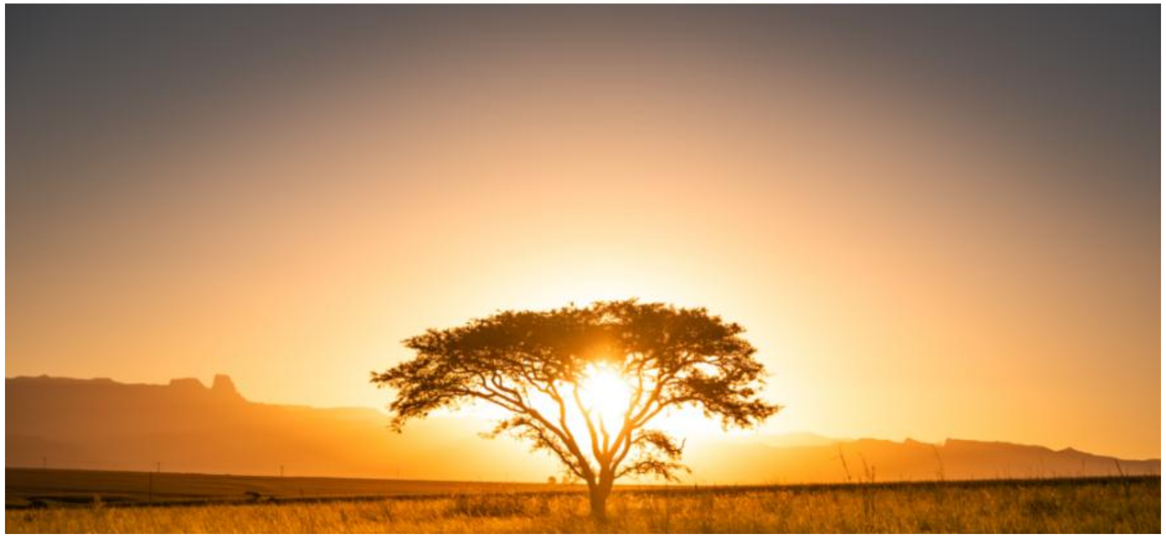
- Impact investing has the potential to deliver extensive social benefits for South African society.
- But to realise this potential, there will need to be a conducive regulatory environment.
- The project's programme of work will lead to a set of proposals across three key areas to stimulate and regulate impact investing in South Africa. These areas are:
    - instrument design and disclosure
    - tax regulation
    - the B-BBEE framework

1. Impact Investing, Bugg-Levine, A and Emerson, J, 2011

How the project will deliver this

- 1. Draft three **policy papers:**
  - Research, analysis, stakeholder mapping
  - Policy objectives and recommendations
- 2. Circulate and **workshop** the papers.
  - to deepen and refine the recommendations
- 3. Develop and publish the **final reports**
- 4. Commence **policyholder engagement**





Workstream outline: Track 2 – Taxation and PBOs

PROBLEM STATEMENT:

- South Africa's tax legislation recognises the role played by family offices, non-profit organisations and corporate foundations, offering exemptions for charitable donations subject to limitations and exempting their core incomes from tax under the Public Benefit Organisation (PBO) regime.

- Yet for the foundations and other impact investors who are actively building the instruments and the market for impact investing, the existing PBO regime does not provide sufficient clarity nor flexibility for the widespread adoption of impact investing either for "mission-aligned" investing, nor for "programmatic" 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 is not aligned with the opportunity for impact investing activities (both programmatic and mission-aligned) to address pressing policy and market failures.

Workstream outline: Track 2 – Taxation and PBOs

OUR VIEW

- Substantial public good can arise from stimulating the impact investing market

OUR APPROACH

- To highlight the weaknesses in the current conceptual model of the PBO regime, primarily with reference to impact investing and social enterprises, to highlight that a tradeoff with other policy objectives of government need not be the outcome

- To reference various international examples of emerging "taxpayer-types"

- To recommend a set of revisions to the taxation guidance and possible amendments to the Income Tax Act to accommodate and encourage more impact investing

Discussion on the issues

Context

- Financial environment is changing:
  - Donor environment is weak (and weakening)
  - Rise of the endowed corporate foundations
  - Growing interest in the intersection of philanthropic capital and private capital from asset managers collaborating to “blend” economic and social returns

- Calls for changes/updates to the PBO legislation in South Africa
  - Committees
  - Research reports
  - Annexure C submissions

Discussion on the issues

Current legislative approach

- Investing generates private benefits; public benefit activities have a cost borne by one party and a benefit borne by another.
- That investing might at the same time generate positive public benefits has not been considered

Issues emerging from the research

1. 9th Schedule – structural differences; perceptions of "rigidity"
2. Partial taxation rules – limits and interpretations of "non-core" activities that generate income
3. Section 18A – 50% distribution rule for Conduit PBOs (18 months) and 5-year distribution rule
4. Absence of regulations for granting of loans under 9th Schedule, Section 1 (p) (iii)
5. Conceptual basis for non-profits – restrictive revenue generation options; use of endowment assets
6. SBFE matters – greater clarity on the extent of business support; flexibility to offer hybrid funding instruments

Emerging recommendations

PBOs

1. Increase the thresholds for business or trading activities to R500,000 or 20% of receipts and accruals in any year.
2. 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
3. Align Part I and Part II of the 9th Schedule of the ITA
4. Draft and promulgate the regulations for lending activities under Part 1 (1)(p)(iii) of 9th Schedule and consider the extension of these to fields other than poverty alleviation
5. Further reduce the distribution requirement for a Conduit PBO in section 18A from 50% to 25%, and extent the period by which such distributions must be made from 18 months to 5 years.
6. Consider creating a new type of taxpayer – a "social enterprise", using international examples.

Emerging recommendations

SBFEs

1. 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.

2. 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.

3. 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

Concluding remarks

- 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
  - 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

- Proposed changes will benefit those philanthropic organisations:
  - with endowment funds to invest (mission- aligned investing) or spend their money in ways other than grants (programme-aligned investing);
  - that wish to build up endowments as a cushion against future fluctuations in funding,
  - That seek to use their skills and resources to earn alternative revenue streams to ensure the financial futures of their operations
- And crowd in more private capital into impact investing structures for blended return, for the benefit of most vulnerable members of society