

Determining the Net Benefits the NPO  
Sector has derived from the 2000 Taxation  
Laws Amendment Act

Developing a Comprehensive Typology of  
Registered NPOs in South Africa

28 February 2004



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## **ABBREVIATIONS**

CBO	Community Based Organization
CSI	Corporate Social Investment
DSD	Department of Social Development
DTI	Department of Trade and Industry
NGO	Non Governmental Organization
NPO	Non Profit Organization
NPP	Non Profit Partnership
SARS	South African Revenue Services
USAID	United States Agency for International Development

# **1 EXECUTIVE SUMMARY**

## **1.1 Overview**

The Non-Profit Organizations Act 17 of 1997 and the Taxation Laws Amendment Act, No. 30 of 2000 was the government's first attempt at creating an enabling legislative and policy environment for the sector. Since the enactment of the above legislation, no attempt has been made to ascertain firstly, the impact on the NPO sector, and secondly whether the intention of the legislation is being achieved.

USAID, through CREA-SA, contracted Umhlaba Development Services to undertake a project to determine the net benefits the non-profit sector has derived from the 2000 Taxation Laws Amendment Act, and to develop a comprehensive typology of registered NPOs in South Africa

Given the paucity of data with regard to both research questions, Umhlaba implemented a methodology to survey a sample of NPOs in order to ascertain actual and projected benefit. A sample survey of 1173 non-profit organizations (NPOs) was utilized to produce the required net benefit analysis. These organizations were randomly sampled from the Department of Social Development (DSD) database of non-profit organizations (registered with DSD), as well as a random sample of Section 21 (non-profit) companies registered with the Department of Trade and Industry (DTI). Based on this survey, financial statements from a sample of 75 NPOs were analyzed to determine the net benefit received from tax registration. This analysis has been extrapolated into the broader sample group of the study. Certain generalizations have been made to the broader population of NPOs in South Africa of the real benefits of the Tax legislation on this sector.

A literature review is included in this report as an overview of work undertaken on the NPO sector in South Africa. This review reflects the dearth of information pertaining to the relationship between NPOs and taxation regulations in South Africa (both past and current). International examples of how taxation laws have impacted on both the net benefit for NPOs as well as the development to the NPO sector are also included.

The development of the research design in this study was partly informed by the most recent study on NPOs by John's Hopkins University. While this study provides a more focused approach to the net benefit of taxation regulation for NPOs in South Africa, the John's Hopkins research is the only substantive study on the NPO sector currently available and therefore provided a number of benchmarks on which to design the current study.

## **1.2 Key findings**

Key findings in this study include:

### **1.2.1 Typology**

The study has examined five independent variables to see their impact on five dependent variables, namely: Awareness of tax regulation; South African Revenue Services (SARS) registration; Type of benefits from registration; Whether the organization received additional funding following the new tax legislation; The size of financial benefit received as a result of registration.

The variables used for the typology are presented mostly as dichotomous:

- CBOs versus NGOs
- Rural-based organizations versus urban-based organizations
- Community-based versus province-based and nation-based organizations
- NPOs versus section 21 companies
- Non-affiliated versus affiliated organizations.

Overall, organizations that define themselves as CBOs, organizations working in the rural areas, organizations based at community level, organizations registered only as NPOs, and organizations that are not affiliated with a network, are:

- Less likely to be aware of the new tax regulations
- Less likely to be registered with SARS
- Less likely to have received benefits from their registration, and if they have received benefits, less likely to have received large ones
- Less likely to have received increased funding.

For the purposes of analysis this overall category of organization was termed *DSD Typology 2*.

The converse of the above typology is that organizations defined as NGOs, based in the urban areas, operating at the provincial and national levels, registered as section 21 companies and members of networks or coalitions, are more likely to be aware of the new tax regulations, more likely to be registered with SARS, more likely to have received benefits from their registration – and if they have received benefits, more likely to have received large ones – and more likely to have received increased funding. For the purposes of analysis this overall category of organization was termed *DSD Typology 1*.

The study also attempts to synchronize SARS NPO categorization for (a) tax exemption and (b) donor deductible status, the Department of Social Development (DSD) NPO categories, and the Johns Hopkins NPO Study (2002). This typology according to tax benefit status provides an indication of the lack of direct correspondence of categories, although as can be noted from the study, there are very few differences between the three systems of categorization, and they can be assimilated without undue difficulty.

### **1.2.2 Net Benefit Analysis**

The study indicates that most NPOs (76%) are eligible for tax benefits for both Schedule 1 and 2, while 19% are eligible for Schedule 1 only, and 5% of NPOs are not eligible for tax benefit as they fall outside the defined SARS categories.

In order to calculate the net benefit of the tax reform legislation of 2000, the study considered four issues: Level of awareness of tax legislation and rate of registration with



SARS; Nature of benefit for NPOs; the timeframe of benefit; and, the scale of benefit by typology.

With regard to the level of awareness, the study found that amongst NPOs determined as Typology 2, levels of awareness of tax legislation remained limited to 54% of NPOs, while this rose 84% for Typology 1. The study found the low level of awareness amongst Typology 2 organizations indicates a significant barrier to uptake of the potential benefits of registration.

From the projections based on the survey results, one may assume that 13 633 NPOs have already registered with SARS, and a further 2 525 NPOs are in the process of registration. This represents 45% of the total population for the study.

The study found that many NPOs have indicated that the benefits that have accrued to them from registration with SARS are not restricted to tax benefit alone. Additional benefits such as increased funds, less tax paid, and an impetus for improved governance are some of the additional benefits identified.

From the extrapolation of the survey results to the number of NPOs registered with SARS, the study estimated that 2 466 NPOs would have increased their resource base as a result of registration, while 2 558 NPOs would have paid less tax as a result of registration. A relatively small number – 467 – of NPOs would have received more corporate funding as a result of registration.

The study considered the issue of the implications of the timeframe for the calculation of net benefit to NPOs. Given that the enactment of the legislation only became applicable in the 2001 tax year, and the long process of and delays in registration with SARS, it is unlikely that benefits accumulated to NPOs prior to the 2003 tax year. In this instance the study assumes that the total net benefit accruing to NPOs would therefore be only for one tax year (2003).

As indicated by the typology, the study found that the two categories of the typology will experience different degrees of actual benefit from registration with SARS. The survey results provided some indication of the scale of benefit accruing to NPOs according to various ranges. From the survey findings, the study estimated the direct benefits accruing to NPOs *who have registered with SARS* were as follows:

- 3 419 NPOs have received direct benefit to a total value of between R0-R12 000
- 690 NPOs have received direct benefit to a total value of between R12 000 – R24 000
- 306 NPOs have received direct benefit to a total value of between R24 000 – R36 000
- 345 NPOs have received direct benefit to a total value of between R36 000 – R48 000
- 154 NPOs have received direct benefit to a total value of above R48 000

The survey indicated that 19% of NPOs registered with SARS had received actual benefit in the form of reduced tax payable. Extrapolated to the full population, this

represents a total figure of 2588 NPOs who had received direct benefit from less tax payable. Based on the analysis of a sample of NPO financial statements, and the extrapolation of the average benefit for each revenue category of NPOs registered with SARS, and who indicated that they *had received a tax benefit*, the *total net benefit to NPOs projected from 2001 to date is R74 551 688.00*.

Given that the number of NPOs that are currently registered with SARS is estimated at 13 633, and that they have yet to receive benefit, it is likely that these organizations will experience some tax benefit in the 2004 tax year. Based on this assumption, the estimated expected benefit for the 13 633 NPOs in the coming financial cycle (2004) will be in the region of R123 178 230.

If further projections are made to the entire population of NPOs in this study (at 34 313 NPOs), an estimate can be calculated based on an assumption that 95% of this population (32 646 NPOs) are eligible for Schedule 1 status (see Table 14). The total potential benefit, if all eligible NPOs are registered and receive benefit, is estimated at R940 422 888.

The study found the benefit accruing to donors is extremely difficult to quantify given the scarcity of data from Corporate Social Investment (CSI) donors, and from SARS. The limited survey of CSIs conducted in this survey have indicated that the benefits have been minimal, and of such a scale as to have warranted little attention by CSI funds. SARS has currently approved and registered 628 applications from NPOs for Schedule 2 status, which will provide the donors of these NPOs with tax exemption on up to 5% of their total income in respect of donations provided to these NPOs. In the face of a total formalized NPO population of 34 313 organizations for this study, the number of Schedule 2 registrations represents only 1.7% of the total number of NPOs.

### **1.3 Conclusions**

The study found there to be limited actual benefit for NPOs from the tax legislation *at this point in time*. It has become increasingly clear in the implementation of this research that the timing of the study has resulted in a quantification of benefit at a very limited scale. In particular, the actual benefits accruing to NPOs has not been felt to a great degree at this point, largely due to a low level of registration, and that the process is at an initial stage of development. There are a number of factors that have contributed to this situation:

- *The limited level of awareness* of the tax legislation by NPOs generally is retarding the rate of registration, although there are indications that the registrations are increasing as awareness is growing..
- The relatively *onerous process of registration with SARS*, coupled with resistance factors is also retarding the rate of registration, and hence benefit.
- The *slow rate of registration by SARS* is retarding the accrual of benefit to NPOs.
- The *lack of systematic coordination of information and registration* between SARS, the NPO Directorate, and the Registrar of Companies (DTI) is creating a climate of confusion for NPOs, further hampering efforts to enhance NPO registration in the NPO database, and with SARS.

The study reflects an overall picture of the registered non-profit sector in South Africa, and the benefits flowing from tax legislation introduced in 2000. This is a short period in which the true net benefit can be calculated. However, this study has also reflected that the governmental institutional arrangements currently do not promote inter-governmental relations in supporting and benefiting NPOs to derive maximum benefits of the legislation. While the findings of this study do provide useful recommendations the absence of information from SARS has hampered the calculation of the net benefit to NPOs in real terms.

