

**MEMORANDUM
LEGAL PRINCIPLES GOVERNING
NON-PROFIT LEGAL ENTITIES**

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Important Note:

The information contained in this Document is general in nature and should not be interpreted or relied upon as legal advice. The information may not be applicable to specific circumstances. Professional assistance should be obtained before acting on any of the information provided in this Document.

1. Available legal structures to set up a nonprofit organisation

Non-profit organisations can essentially operate through the following forms of legal structures in South Africa namely: voluntary associations, non-profit trusts, non-profit companies and external companies.

1.1 Voluntary Association

A voluntary association is an agreement between three or more persons to achieve a common objective. The making of profits cannot be the main objective of a voluntary association. It is a popular option amongst smaller community-based initiatives. It is regulated by common law, not statute. The voluntary association is not required to be registered with a public office in order for it to exist.

1.2 Non-profit Trust

A trust is established in terms of the Trust Property Control Act of 1988 (the Trust Act). Different forms of trusts can be established, including; business trusts, family trusts, testamentary trusts and non-profit trusts. The trust deed is the distinguishing feature between the different kinds of trusts.

The Master of the High Court is responsible for the registration of trusts and authorises the appointment of trustees. The Trust Act requires that the first trustees must lodge the trust deed with the Master of the High Court. Trustees can only act in their capacity as trustees after having been authorised to do so in writing by the Master.

1.3 Non-profit Company

The Companies Act of 2008 provides for the incorporation of a non-profit company which can be incorporated for a public benefit objective or an objective relating to one or more cultural or social activities, or communal or group interests. The Companies Act recognises the non-profit company as a separate category of company which must have a minimum of three directors and can be established with or without members

It can be incorporated by submitting a copy of its completed and signed Memorandum of Incorporation and filing a Notice of Incorporation with the prescribed fee and supporting documentation with the Companies and Intellectual Property Commission (CIPC).

1.4 External Company

The Companies Act of 2008 provides for the registration of an external company which can either be a non-profit or for-profit company. No new company comes into existence with the registration of the external company. The foreign company is merely registered (not incorporated) in terms of the Companies Act.

2. Defining elements of the four options

2.1 Voluntary Association

A voluntary association does not have inherent legal personality. The voluntary association must essentially meet three requirements in order to have legal personality, namely:¹

- a) Have perpetual succession,
- b) Be able to hold property distinct from its members, and
- c) Stipulate in its constitution that no member has any rights by reason of his/her membership to the property of the voluntary association.

The voluntary association is regarded as a separate legal entity if the above requirements are reflected in its constitution.

2.2 Non-profit Trust

A non-profit trust can only be established in terms of the Trust Act. A trust is defined, for purposes of this document, as the arrangement through which a founder's property is transferred to the trustee who must administer it for a particular purpose. The trustees must comply with the provisions of the trust deed, common law and the Trust Act. A trust is a very flexible structure and can be found in different forms. This document focuses on the non-profit trust.

The South African courts have determined that a trust is not a separate legal person but a legal institution, *sui generis* (meaning a unique form of entity). The assets and liabilities of a trust vest in the trustees in their official capacity – not in their personal capacity.

The lack of a separate legal personality does not mean that trustees are more liable in their personal capacity compared to directors of a company. The lack of legal personality does not mean trustees are automatically liable in their personal capacity.

2.3 Non-Profit Company

In terms of the Companies Act, a non-profit company must be incorporated for a public benefit or for one or more cultural or social activities, or for communal or group interests. The non-profit company must operate consistent with the principles contained in Schedule 1 of the Companies Act. For example, the income and property of the non-profit company must not be distributable to its incorporators, members, directors, officers or persons related to any of them except as allowed for under Schedule 1. This would include reasonable compensation and reimbursement for expenditure incurred on behalf of the non-profit company.

A company is, upon its incorporation, a juristic person. Section 19 confirms that company is a juristic person, which exists continuously until its name is removed from the companies register in accordance with the Companies Act. In essence, the non-profit company exists separate from its directors and members.

¹ Bamford, "The Law of Partnership and Voluntary Association in South Africa", Third Edition, Juta, 1982, page 128

2.4 External Company

The external company means a foreign company that is carrying on business or non-profit activities, as referred to in the Act, within South Africa. Conducting business or non-profit activities within South Africa means the company:

- a. is a party to one or more employment contracts within South Africa;
- b. has engaged in a course or pattern of activities within South Africa over a period of at least six months, such as would lead a person to reasonably conclude that the company intended to continually engage in business or non-profit activities within South Africa.

The following activities would **not** be regarded as "conducting business activities, or non-profit activities:

- a) Holding a meeting or meetings within South Africa of the shareholders or board of the foreign company, or otherwise conducting any of the company's internal affairs within South Africa;
- b) Establishing or maintaining any bank or other financial accounts within South Africa;
- c) establishing or maintaining offices or agencies within South Africa for the transfer, exchange or registration of the foreign company's own securities;
- d) Creating or acquiring any debts within South Africa, or any mortgages or security interests in any property within South Africa;
- e) Securing or collecting any debt, or enforcing any mortgage or security interest within South Africa; or
- f) Acquiring any interest in any property within South Africa.

3. Founding document

3.1 Voluntary Association

The founding document for a voluntary association is a constitution. The constitution is an *agreement* between three or more persons to pursue a particular objective. The constitution sets out the basis of that agreement. This means that when the members adopt the constitution of the organisation, they are in fact entering into an agreement that will govern how the organisation operates.

Our courts have summed up the position as follows

*A voluntary association is founded on a contractual basis. The constitution of a voluntary association, together with its rules or regulations, collectively constitutes the contract which is entered into by its members. The contract under which a voluntary association functions determines the nature and scope of the association's existence and activities, prescribes the powers to those who are charged with its affairs and demarcates and regulates the rights of members. As to the interpretation of such a constitution, the same principles of construction should be applied as in the construction of any written contract.*²

² *Jacobs v Old Apostolic Church of Africa and Another* 1992 (4) SA 172 (TK)

3.2 Non-profit Trust

The Trust Act defines the trust deed as a written agreement according to which a trust is created. Once the trust deed has been signed by the initial donor and the trustees it is considered a 'written agreement' and a trust is been 'created'. The agreement exists even though it has not yet been lodged with the Master's office. The initial donor is the person who will make the initial donation to the trust. This may an individual or a legal entity. There may also be more than one initial donor. Within the context of an international organisation setting up a South African-based trust, the international organisation may be the initial donor.

This means that the trust is, similar to a voluntary association, also established on a contractual basis. The trust deed is subject to the Trust Act, but the same principles of interpretation that would apply to a contract would apply to the trust deed. The trust deed would usually include clauses dealing with; the objectives of the trust, the powers of trustees, meetings of the trustees, financial matters, amendments to the trust deed and dissolution of the trust. Paragraph 12 below provides a summary of what should be in the trust deed of a non-profit trust if it wants to register in terms of the Nonprofit Organisations Act.

3.3 Non-profit Company

The founding document of the non-profit company is the Memorandum of Incorporation. The CIPC has prepared prescribed Memoranda of Incorporation that can be used by non-profit companies, but it is also permissible to prepare a unique memorandum of incorporation for a non-profit company. The Memorandum of Incorporation is also interpreted according to the principles of contract.

3.4 External Company

The external company retains its founding document which it uses for incorporation in its country of origin. No new founding document is used when registering the external company in South Africa. The external company will, with reference to its operations in South Africa, be governed pursuant to the relevant provisions of the Companies Act of South Africa and its own founding document. As the company is incorporated in terms of law outside of South Africa, it is still bound by the laws of incorporation in its country of origin.

4. Formation

4.1 Voluntary Association

The voluntary association is established in terms of common law. This means that once the members have agreed to the contents of the constitution which captures the relevant provisions, a legal entity comes into existence. However, the activities of the voluntary association may be restricted as it would ordinarily not be able to open a bank account unless it is registered in terms of the Nonprofit Organisations Act.

4.2 Non-profit Trust

The formation of a trust is not a complex procedure. The Trust Act requires that the first trustees must lodge the trust deed with the Master of the High Court and pay registration

fee of R250. In addition to the trust deed, that all initial trustees must each also complete and sign an *Acceptance of Trusteeship* form. There is no requirement for a minimum number of trustees in the Trust Act. However, should the trust apply for approval as a public benefit organisation, it must have at least three trustees who are not related to one another.

The Master's office may require the trustees to furnish security to the satisfaction of the Master for the due and faithful performance of their duties.

Registration takes place locally in the province where the trust property will be held. It usually takes about three to four weeks for the Master's office to register a trust once a complete application has been submitted. Different provinces may however have different processing times. There is not yet provision for the electronic lodgment of an application to have a trust registered.

4.3 Non-profit Company

The Companies Act requires non-profit companies to have at least three directors. A non-profit company may be established with or without members. The use of the name of the company must be reserved with the CIPC.

The incorporators must complete a Notice of Incorporation, a Memorandum of Incorporation and the prescribed forms capturing the information of the directors. The CIPC has not yet introduced an electronic registration process for non-profit companies. Registration takes place at a central location, being Pretoria. It ordinarily takes about three months or more for the CIPC to incorporate a new non-profit company.

4.4 External Company

The external company is registered by completing the prescribed forms and lodging, amongst other, the following documents with the CIPC:

- a) Certified copy of Certificate of Incorporation of the External Company,
- b) Certified copy of the founding document of the External Company,
- c) Certified copies of the Passport for all Directors,
- d) Powers of Attorney issued by the Directors to legal representative,
- e) Certified copy of Passport for Person Authorised to Accept Service of company documents in South Africa, and
- f) Resolution by External Company to register in South Africa (see below for sample).

The Companies Regulations require the external company to provide a translation of the Certificate of Incorporation and founding document - if it is not in English. The following information is required for each of the directors:

- a) Full forenames and surname (and any former forenames and surname),
- b) Nationality,
- c) Occupation,
- d) Residential, business and postal addresses,
- e) Date of appointment, and
- f) Email address and cell phone number

External companies must also appoint a local person to accept service of documents in South Africa.

5. Record-keeping, Reporting & Regulation

5.1 Voluntary Association

A voluntary association must comply with the record-keeping and regulatory requirements listed in its own constitution. The voluntary association is not required to be registered in terms of the Nonprofit Organisations Act in order to exist. However, once the voluntary association is registered in terms of the Nonprofit Organisations Act, it must comply with the requirements in terms of that Act.

The common law itself does not compel voluntary associations to prepare and publish financial reports. Usually the VA's constitution lays down the requirements pertaining to financial reporting. If, for example, the constitution requires the VA to prepare and publish audited financial statements, its governing board must do so.

5.2 Non-profit Trust

Trustees are not obliged, in terms of the Trust Act, to regularly submit audited financial statements. The trust deed may however require that audited financial statements be prepared. Trustees must, at the written request of the Master of the High Court, account for their administration and disposal of trust property. The trustees may also be required by the Master to deliver any book, record, account or document relating to the administration or disposal of the trust property. The Master's office may also conduct an investigation into the trustee's administration and disposal of trust property.

The Master's office usually requires trustees to submit a letter from an auditor in which case the trustees will be exempted from paying security. It is generally uncommon for the Master's office to require security from trustees for the setting up of a non-profit trust. The letter from the auditor would state the following:

- 1. I am a registered accountant/auditor practising at [address],*
- 2. I have been requested by the Initial Trustees of the Trust to be registered under the name of [Trust], to do the annual audit (or certification of the finances) of the Trust,*
- 3. In compliance with the requirements of the Master of the High Court, I undertake to advise the Master's office of the following:*
 - 3.1 Should I cease to act in the Trust,*
 - 3.2 The name of the new auditor/accounting officer should I be aware thereof,*
 - 3.3 Should the Trust not have been administered in accordance with the terms and conditions of the trust deed, and*
 - 3.4 Any substantial addition, to the capital of the Trust and the value thereof.*

In the absence of this prescribed form, the Master's office may require Trustees to pay security for the execution of their functions. The Trust Deed may however require that audited financial statements be prepared

5.3 Non-profit Company

A non-profit company is not required, in terms of the Companies Act, to have audited financial statements prepared or to appoint a company secretary. The Memorandum of Incorporation of the company may require that the company prepare an audit report and appoint a company secretary, auditor and an audit committee. *If so*, the audited financial statements must in that case be approved by the board of directors and signed by an authorised director.

Non-profit companies must each year prepare annual financial statements within six months after the end of its financial year. All financial statements of the non-profit company must comply with the conditions laid down in the Companies Act. The non-profit company may have a choice as to whether its financial statements are audited or independently reviewed. The Companies Regulations provide for the categorisation of companies according to a 'public interest score'. Companies are required to adhere to the minimum financial reporting standards stipulated for its particular category. Every company must calculate its 'public interest score' at the end of each financial year. Factors that determine the 'public interest score' include: the number of employees, the company's turnover and number of members of the Company. The applicable financial reporting standards are prescribed under the Companies Regulations. The NPC's MOI may provide for its financial statements to be audited

5.4 External Company

The Companies Act is somewhat ambiguous about the application of the regulatory requirements of the Companies Act. This is because the definition of 'company' in terms of the Companies Act does not explicitly include external companies. It would however be safer to assume that the requirements relating to financial reporting are also applicable to external companies.

External companies are expressly, in terms of the Regulations, required to file annual returns.

6. Standard of conduct required of Boards

6.1 Voluntary Association

The standard of conduct required from board members of voluntary associations are captured in terms of common law. In essence, board members are expected to comply with the mandate listed in the constitution and not act beyond the authority and powers listed in the constitution. They must act in the best interests of the voluntary association and must avoid situations where their personal interests' conflict with the interests of the voluntary association.

6.2 Non-profit Trust

Section 6 of the Trust Act requires that trustees must in the performance of their duties and the exercise of their powers act with the care, diligence and skill which can reasonably be expected of a person who manages the affairs of another. If trustees do not comply with this responsibility it would amount to a breach of trust. Trustees also have a duty to account for and to be impartial in executing their responsibilities. The courts have also made it clear that trustees must avoid a clash of their own interest with that of the trust.

6.3 Non-profit Company

The Companies Act contains a number of provisions that are important in relation to the standard of conduct of directors and their liability. It goes into more detail compared to the Trust Act. Directors are required to exercise their powers and perform their functions in good faith and for a proper purpose and in the best interests of the company. And similar to the Trust Act, directors must also exercise particular degree of care, skill and diligence that may reasonably be expected of a person carrying out the same functions. This is similar wording to that of the Trust Act, but is the standard is different as the Trust Act refers to *a person who manages the affairs of another* which is, in my view, a higher standard of responsibility.

The Companies Act provides further conditions as to when the director would have absolved him or herself from these standards. A number of sub-sections are also devoted towards the manner in which directors must declare any personal financial interests and how the company must deal with those interests. The Companies Act also makes provision for directors to rely on the advice of employees, legal counsels, accountants and other professional persons in performing its functions.

6.4 External Company

Again, the Companies Act is somewhat ambiguous about the application of the standard of conduct expected from directors of external companies. It would however be safe to assume that the requirements relating to standards of conduct are also applicable to external companies.

7. Qualification of Board Members

7.1 Voluntary Association

The qualification requirements for board members are usually stipulated with the constitution of the voluntary association.

7.2 Non-profit Trust

In essence, there are no restrictions on the qualifications of trustees. However, the Master's office may exercise its discretion to remove a trustee as provide for pursuant to the Trust Act. The Master has the discretion to remove trustees from office under certain circumstances, including situations where trustees have been convicted and imprisoned for an offense related to dishonesty, or have been declared by a court to be mentally ill or incapable of managing their own affairs, or failed to perform satisfactorily any duty

imposed upon them by them, or did not provide security. A juristic person can serve as a trustee.

7.3 Non-profit Company

The Companies Act lists several factors that would make someone either ineligible or disqualified from taking up office as a director in a company. For example, juristic persons and unemancipated minors are ineligible to serve as directors. A number of persons are also disqualified to become directors, including; unrehabilitated insolvents, and those who have been convicted of certain offences involving dishonesty.

7.4 External Company

The Companies Act is also ambiguous about the qualification requirements pertaining to directors of external companies. Again, it would be safe to assume that the requirements relating qualification requirements for Directors are also applicable to external companies.

8. Liability of Board Members

8.1 Voluntary Association

Board members of voluntary associations may generally be held liable if they act beyond the scope and authority laid down in the constitution. Board members may also be held liable if they carry on the affairs of the voluntary association in a reckless or fraudulent way.

8.2 Nonprofit Trust

Despite the fact that the trust is not a separate legal entity, trustees also enjoy limited liability. Trustees are not personally liable for the debts of a trust. A trustee may however be personally liable for loss suffered by the trust in the event that he or she has failed to discharge his or her fiduciary duty.

8.3 Non-profit Company

Directors may be held liable if they breach any provision of the Companies Act (including their duties) and any provision of the company's Memorandum of Incorporation.

NB: This liability extends to members of a committee appointed by the board – irrespective whether that person is a member of the company or not.

Directors will also be held liable for loss, damages or costs sustained by the company in situations where the director, amongst other:

- a) Acted beyond the scope of his/her authority,
- b) Participated in reckless, grossly negligent or fraudulent trading, and
- c) Knowingly signed, consented or authorised the publication of materially false or misleading financial statements.

8.4 External Company

Directors of external companies are, in my view, required to comply with the same standards of conduct of local companies when operating in South Africa.

9. Remedies and Enforcement

The Master exercises both an administrative and supervisory function in relation to trusts. In an administrative capacity it receives and files the trust deeds and amendments thereto. It also has to receive resignations from trustees. In addition to the administrative function, the Master is also responsible for authorising trustees to act in their capacity as trustees, appoint new trustees in certain circumstances and to conduct investigations in certain instances. The Master also has the power to approach the court in certain instances to ensure compliance with the Trust Act or even to have a trustee removed from office. Trustees may also be called upon to account to the Master on the administration of the trust and disposal of trust property.

The Companies Act provides for the establishment of the CIPC which has more functions and powers compared to the Master's office. Options available for alleged contraventions or enforcements of provisions or rights under the Companies Act can potentially be resolved through; alternative dispute resolution, adjudication by the Commission or the Companies Tribunal, approaching the High Court or filing a complaint with the Commission. The Companies Act is more extensive and advanced in its available mechanisms to deal with non-compliance, disputes and other internal challenges.

10. Dissolution and Deregistration

The procedure for dissolving a voluntary association and trust is less expensive and complicated compared to a company if those entities are solvent. The trust and voluntary association will not be required to appoint a liquidator to wind their affairs up. The situation is however different if the trust and voluntary association are deemed to be insolvent in which case the procedures as laid down in the Insolvency Act must be complied with.

The Companies Act provides for the winding up and deregistration of companies. Dissolution of solvent companies involves the appointment of a liquidator which may be an expensive exercise for a solvent non-profit company that wants to wind up its affairs. An alternative process of deregistration at the instance of the Commission provides for a more simplistic option to deregister a company without having to go through the winding up procedure. A deregistered company may however be reinstated through application. The Companies Act also provides for the removal of a company's name from the companies register but that does not affect the liability of any former director or shareholder of the company or any other person in respect of any act or omission that took place before the company was removed from the register.

11. Factors to consider when setting up a non-profit organisation in South Africa

Both internal and external factors should be considered when making the choice between the two options. No one factor should determine the choice for a legal entity.

- a) **Complexity** – The Companies Act of 2008 (about 200 pages in length) represents a significant improvement in comparison to its predecessor existing Companies Act. The Trust Act (less than 10 pages in length) remains the front runner in simplicity compared to the Companies Act. This is an important factor to keep in mind when dealing with board members who are not familiar with the local legal system.
- b) **Capacity** – This is related to the issue of complexity. Added accountability and responsibility comes with the more comprehensive Companies Act. Directors must accordingly be prepared to read, understand and comply with the Companies Act.
- c) **Internal accountability** – It is possible for a trust to incorporate some of the positive elements contained in the Companies Act as part of its operating policies and procedures to add to the internal accountability of the trust.
- d) **Powers of the entity** – This is not an important issue to consider when deciding on an appropriate legal entity. All the different legal entities can have the same power.
- e) **Foreign board members** – It is possible, in theory, for all entities to have board members who are not located in South Africa. The Directorate for Nonprofit Organisations has in the past refused to register voluntary associations that are solely made up of foreign board members. This is not legally correct, but unfortunately delays the process significantly if appeal procedures are pursued.
- f) **Processing times of applications** – Processing times may fluctuate over time. The processing times for the two forms of companies are in essence the same. It usually takes less than 25 business days to incorporate a non-profit company or to register an external company. It usually takes about three to four weeks to register a trust. As indicated, a voluntary association can be established fairly quickly, but would not be able to open a bank account unless registered in terms of the Nonprofit Organisations Act.
- g) **Opening of bank account** – It may be a challenge to open a bank account if the non-profit entity consists of only foreign board members. I normally recommend that clients appoint two local persons to register the trust and to open a bank account. Foreign trustees can be appointed once a bank account has been opened. This usually means a delay of about 3-4 weeks before the application for PBO approval can commence.
- h) **Tax** – When choosing a legal entity, the issue of tax usually does *not* make a difference if the organisation becomes an approved PBO. It should however be taken into account that external companies are treated differently in this regard. Please see comments below.

- i) **Other** laws – Board members of non-profit organisations must ensure that it complies with several other laws. Compliance with these laws may be cumbersome and should be kept in mind when making a decision for an appropriate legal structure. For example, an organisation that employs people should take into account the applicability of up to six labour-related laws.

12. Registration in terms of the Nonprofit Organisations Act

The Nonprofit Organisations Act of 1997 (the NPO Act) provides for a voluntary registration facility for voluntary associations, non-profit trusts and non-profit companies. **Please note:** External companies are not eligible for registration in terms of the NPO Act.

The NPO Act defines a *nonprofit organisation* as a trust, company or other association of persons established for a public purpose and the income and property of which are not distributable to its members or office-bearers except as reasonable compensation for services rendered. Section 12 of the NPO Act lays down a number of requirements that must be adhered to in order for a non-profit organisation to be registered in terms of the NPO Act. Its founding document (or the law in terms of which it has been established) must cover the following matters:

- *state the organisation's name;*
- *state the organisation's main and ancillary objectives;*
- *state that the organisation's income and property are not distributable to its members or office-bearers, except as reasonable compensation for services rendered;*
- *make provision for the organisation to be a body corporate and have an identity and existence distinct from its members or office-bearers;*
- *make provision for the organisation's continued existence notwithstanding changes in the composition of its membership or office-bearers;*
- *ensure that the members or office-bearers have no rights in the property or other assets of the organisation solely by virtue of their being members or office-bearers;*
- *specify the powers of the organisation;*
- *specify the organisational structures and mechanisms for its governance;*
- *set out the rules for convening and conducting meetings, including quorums required for and the minutes to be kept of those meetings;*
- *determine the manner in which decisions are to be made;*
- *provide that the organisation's financial transactions must be conducted by means of a banking account;*
- *determine a date for the end of the organisation's financial year;*
- *set out a procedure for changing the constitution;*
- *set out a procedure by which the organisation may be wound up or dissolved; and*
- *provide that, when the organisation is being wound up or dissolved, any asset remaining after all its liabilities have been met, must be transferred to another nonprofit organisation having similar objectives.*

A prescribed application form must be completed when application is made for registration in terms of the Nonprofit Organisations Act. A registered nonprofit organisation is issued with a certificate of registration which is sufficient proof that the organisation is registered in terms of the NPO Act and is a body corporate.

A registered nonprofit organisation is required to reflect its registered status and registration number on all of its documents.

Reporting requirements:

Accounting Records - Registered NPOs must keep, accounting records in line with the standards of the generally accepted accounting practice of its income, expenditure, assets and liabilities and draw up financial statements within six months of its financial year-end which must include:

- An income and expenditure statement, and
- A balance sheet reflecting its assets and liabilities.

Accounting officer's report - An accounting officer must compile a written report within eight months of the organisation's financial year-end stating whether or not the organisation's:

- Financial statements and accounting records are consistent.
- Accounting policies have been appropriately applied with the preparation of the financial statements, and
- Financial conduct has complied with the provisions of the NPO Act and its own constitution.

Section 18 (4) of the NPO Act provides that if the accounting officer of a registered nonprofit organisation becomes aware of any instance in which the organisation has failed to comply with the financial provisions of this Act or its constitution, the accounting officer must notify the director of the occurrence—

- (a) within one month after becoming aware of it; and
- (b) in writing with sufficient detail to describe the nature of the noncompliance.

Section 18 (5) of the NPO Act further provides that the above duty imposed on an accounting officer supersedes the duty of confidentiality owed to the organisation by the accounting officer.

Reporting to NPO Directorate – Registered NPOs must provide with Director of NPOs:

- Within one month after any appointment or election with the names and physical, business and residential addresses of its office-bearers,
- Within one month before a new address for service of documents will take effect with a notice of any change of address,

- A narrative report of its activities in the *prescribed* form together with its financial statements and the accounting officer's report as required in terms of the Act, within nine months after the end of its financial year, and
- A physical address in the Republic for the service of documents to be received from the Directorate of Non-profit Organisations.

**EXTRACTS FROM SAIBA's GUIDE TO
ACCOUNTING OFFICER ENGAGEMENTS FOR NPOs**

Section 60 of the Close Corporations Act empowers the Minister of the Department of Trade and Industry to issue a notice appointing professional bodies whose members may act as accounting officers. SAIBA has been appointed as controlling body for accounting officers since 1987. Only those SAIBA members with the designation BAP(SA) are recognised as accounting officers.

It is the duty of an NPO to appoint an accounting officer. If an accounting officer accepts the appointment then the terms of the engagement should be specified in an engagement letter issued by the accounting officer to the NPO.

The accounting officer should ensure, with representatives of the entity and, where appropriate, with other specified parties who will receive copies of the report, that there is a clear understanding regarding the accounting officer engagement procedures and the conditions of the engagement.

It is important to note that the NPO Act does not specify the procedures that the accounting officer should follow prior to issuing an accounting officer report for the NPO. The accounting officer should therefore agree the scope and procedures with the NPO. This agreement should be stipulated in an engagement letter.

It is common cause that accounting officers should perform their duties to a professional standard as is expected of a professional acting in the public interest

- Accounting officers are required therefore to perform their duties in terms of:
- Common law requirements of care, skill and diligence,
- Contractual requirements as agreed to between the parties,
- Professional standards and codes applicable to accounting officers that are members of a professional body such as SAIBA, and
- Any other statutory requirements and obligations.

The duties of accounting officers are explicitly stated in the NPO Act. However, in addition to these statutory duties, accounting officers have certain common law duties such as:

- Performing engagements with professional competence and due professional care,
- Planning and supervising the engagement performance, and
- Obtaining sufficient relevant data to afford a reasonable basis for issuing an accounting officer report.

In addition to the above duties an accounting officer should comply with the code of ethics of the professional body of which he is a member. SAIBA has adopted the IFAC Code of Ethics for Professional Accountants ('the Code')

Part A of the IFAC Code sets out the fundamental principles that should be observed by all professional accountants. These are:

- Integrity,
- Objectivity,
- Professional competence and due care,
- Confidentiality, and
- Professional behaviour.

Part B of the IFAC Code illustrates how the conceptual framework contained in Part A is to be applied by professional accountants who offer their services for a fee ie act in private or public practice. The Code advises that any threats to the conceptual framework should be avoided. Part B of the Code provides a case study approach to explaining the principles that should be followed with regard to:

- Professional appointment,
- Conflicts of interest,
- Second opinions,
- Fees and other types of remuneration,
- Marketing of professional services,
- Gifts and hospitality,
- Custody of client assets, and
- Independence related to audit and review and other assurance engagements.

A system of quality control will provide a firm of accounting officers with reasonable assurance that the firm and its personnel comply with professional standards and

regulatory and legal requirements, and that reports issued by the firm or accounting officer are appropriate in the circumstances.

Accounting officers should therefore adopt a standard of quality control appropriate for the engagements they undertake. It is preferable that professional firms adopt the IFAC International Standard on Quality Control (ISQC1) with amendments as required in the circumstances.

Independence is not a prerequisite before a person may accept the appointment to issue an accounting officer report. The NPO Act does not place any limitation on whether the accounting officer may also prepare the financial statements or be a director or employee of the NPO. The engagement letter between the NPO and the accounting officer should therefore address this issue.

Unless otherwise required by a statute or regulation the accounting officer is not generally required to:

- Obtain an understanding of internal controls,
- Perform substantive testing, or
- Perform a test of balances

General provisions relating to registered NPOs

A register of all registered non-profit organisations is maintained by the Directorate for NPOs and is open to the public.

All documentation lodged with the Directorate, such as the founding documents, financial and narrative reports of the organisations are available for public inspection. Written copies can be requested at a cost or the documents must physically be inspected at the offices of the Directorate in Pretoria.

13. Taxation of non-profit organisations

Eligible external companies and local non-profit entities, as captured above, may apply for approval as a public benefit organisation (partial tax exemption) should they be eligible. Should a PBO generate trading income in excess of the categories are allowed for under section 10 (1) (cN) of the Income Tax Act it will be taxed on same rate as companies, not as trusts.

Non-profit organisations can access a number of benefits in terms of the Income Tax Act. These benefits can significantly contribute towards the financial sustainability of a non-profit organisation (NPO).

The main tax benefits for NPOs:

The main benefits available to NPOs are:

1. Being fully exempted from paying income tax if it carries on no or limited trading activities. And being partially exempted from paying income tax in situations where its trading income exceed the limitations contained in Section 10 (1) (cN).
2. Being able to receive donor deductible contributions. Only approved PBOs with status in terms of section 18A can issue receipts to their donors for donations received which will allow the donors to make deductions from their taxable income. **Please note:** this benefit is not available to external companies.
3. Accessing other tax benefits that are dependent on the organisation's PBO status. These include exemptions from transfer duty, estate duty, capital gains tax, donations tax, skills development levy and dividends tax.

An organisation's approval as a PBO is ordinarily the main gateway to access the benefits listed above. Most non-profit organisations will have to become approved public benefit organisations in order to access tax exemption, donor deductible contributions and the other tax benefits as listed in paragraph 3 above.

PBO Approval:

Section 30 provides that the Commissioner for the South African Revenue Service (SARS) can only approve PBOs that comply with the requirements listed in that section. In order to become an approved PBO, an organisation must be a non-profit organisation in the form of:

- A non-profit company
- A non-profit trust, or
- An Association of Persons.

And it must carry on one or more public benefit activities (PBAs) listed in Part I of the Ninth Schedule to the Income Tax Act. NPOs must complete the prescribed application form (**EI 1**) and submit it in the prescribed manner.

Section 30 further requires that the NPO's founding document must contain prescribed clauses dealing with the following issues:

- At least three persons who are not related to each other must accept the fiduciary responsibility of the PBO.
- Ensure that no single person directly or indirectly controls the decision making powers relating to the PBO.

- The funds of the PBO cannot be distributed to any person, except in the course of carrying on its public benefit activity.
- The PBO must upon dissolution, transfer its assets to any similar approved PBO, a prescribed parastatal or a government department.
- The PBO is not allowed to accept any donation which may be revoked by the donor for reasons other than a material failure to conform to the designated purposes and conditions of such donation, including any misrepresentation with regard to the tax deductibility thereof in terms of section 18A.
- Any amendment to the PBO's founding document must be submitted to the Commissioner.

(If these clauses are not in the founding document, three fiduciaries of the organisation can sign a *Written Undertaking EI2* confirming that the organisation will comply with the above conditions. External companies must complete the **Written Undertaking EI3**)

Please note: An external company is required, on termination of its activities South Africa, to transfer the assets of the company to a local PBO or other specified entity, if more than 15 per cent of the receipts and accruals attributable to the company during the period of three years preceding that termination are derived from a source within South Africa. If not, the assets of the external company may in principle be withdrawn from South Africa.

Other conditions:

The organisation must satisfy the Commissioner that it:

- Is or was not knowingly a party to any transaction, operation or scheme of which the sole or main purpose is or was the reduction, postponement, or avoidance of liability for any tax, duty or levy.
- Does not pay employees or office-bearers excessive remuneration, having regard to what is generally considered reasonable in the sector and in relation to the service rendered. It complies with the reporting requirements determined by the Commissioner.
- Takes reasonable steps to ensure that funds are utilised for the purpose for which it had been provided, if it is providing funding to an association of persons engaging in public benefit activities.
- Has not or will not use its resources directly or indirectly to support, advance, or oppose any political party.
- Complies with such conditions as the Minister of Finance may prescribe by way of regulation.

It must be noted, at this stage, that section 18A(1)(a) of the Act requires two forms of approval. First, approval as a public benefit organisation by the Commissioner under section 30³, and, second, approval by the Commissioner for purposes of section 18A⁴.

³ Section 18A(1)(a)(i)

⁴ Section 18A(1)(a)(i)(cc)

To obtain approval by the Commissioner for the purposes of section 18A, a public benefit organisation must, amongst other:

1. Be a public benefit organisation contemplated in paragraph (a) (i) of the definition of “public benefit organisation” in section 30 (1)⁵; and
2. Carry on in South Africa any public benefit activity contemplated in Part II of the Ninth Schedule.

Section 18A(1)(a) adds two important requirements for approval by the Commissioner for the purposes of section 18A, i.e.:

1. the location of the public benefit activity (in South Africa⁶; and
2. the nature of the public benefit activity (only those under Part II of the Ninth Schedule).

Section 18A of the Income Tax Act provides that donations made pursuant thereto must be ‘bona fide donations’:

18A. Deduction of donations to certain organisations.—

(1) Notwithstanding the provisions of section 23, there shall be allowed to be deducted from the taxable income of any taxpayer so much of the sum of any **bona fide donations** by that taxpayer in cash or of property made in kind, which was actually paid or transferred during the year of assessment to—

Section 54 of the Income Tax Act provides that ‘donation’ means any gratuitous disposal of property including any gratuitous waiver or renunciation of a right⁷. In the matter of *Ovenstone v Secretary for Inland Revenue 1980 (2) SA 721 (A)* at 763H-737A the Supreme Court of Appeal (Appellate Division), as it was then known, stated: “*In a donation the donor disposes of the property gratuitously out of liberality or generosity, the donee being thereby enriched and the donor correspondingly being impoverished, so much that, if the donee gives any consideration at all therefor, it is not a donation.*”⁸

⁵ This excludes part (ii) which refers to any organisation which is a branch within South Africa of non-profit entities formed or established in a foreign country.

⁶ The Davis Tax Committee reports that: “The justification is to be found in a Tax Court decision in ITC 1872; 2014 (76) SATC 225 where the Court held that authority to issue a tax deductible receipt under s18A of the Act has an effect of reducing the tax base in the Republic. The donors of such donations are issued with tax deductible receipts on the basis of which they can claim a tax deduction based on such donations and therefore reduce a tax base in the Republic. Hence only donations used to carry on PBAs in the Republic should qualify under section 18A of the Act.”

⁷ The PBO Guide states that: “It is a voluntary gift which is freely given to the donee. There must be no *quid pro quo*, no reciprocal obligations and no personal benefit for the donor.”

⁸ In the matter of *Commissioner for Inland Revenue v Estate Hulett [1990] ZASCA 23*, the Supreme Court of Appeal commented that the word donation in our law has acquired the meaning of “a gratuitous disposal of property prompted by motives of sheer liberality or disinterested benevolence”.

In the matter of *Jordaan and Others NNO v De Villiers 1991 (4) SA 396 (C)* at 400F-G, the court stated: “Moreover, whilst there is no presumption in our law against donations, the Court is entitled to take into account that, human nature being what it is, people do not ordinarily part with their property for nothing ... Thus, whilst the incidence of the burden of proof remains unaffected, the evidence of the party contending for a donation in his favour calls for careful scrutiny.”

The Supreme Court of Appeal, in the matter of *Welch v Commissioner for the South African Revenue Service (23/2003) [2004] ZASCA 40* stated that the common law regards the following element as essential to a donation: “that the disposition be motivated by pure liberality or disinterested benevolence and not by self-interest or the expectation of a quid pro quo of some kind from whatever source it may come.”

Reporting requirements:

An organisation approved as a PBO with SARS must submit annual income tax returns (IT 12EI) in the prescribed format. PBOs are required to submit their tax returns within a period of twelve months after their financial year end. PBOs are not generally required to submit audited financial statements. It is only in certain instances that PBOs will be required to submit an audit certificate. This would be in situations where a PBO carries on public benefit activities that are listed on Part II of the Ninth Schedule of the Income Tax Act and on Part I and which are not also on Part II. In such cases the PBO will have to submit, with its tax return, an audit certificate to the South African Revenue Service indicating that donations received for which s18A receipts were issued were only used for activities on Part II of the Ninth Schedule.

Summary of similarities and Differences between PBOs and *registered* NPOs

SIMILARITIES	
Registered Nonprofit Organisations	Approved Public Benefit Organisations
Application for NPO registration is voluntary.	Application for PBO approval is voluntary.
Voluntary associations, non-profit trusts and non-profit companies are eligible for registration. External companies are not eligible for registration.	Voluntary associations, non-profit trusts and external & non-profit companies are eligible for approval. Must carry on public benefit activities as defined in the Income Tax Act. External Companies are not eligible for donor deduction (section 18A status).
Must operate for a public purpose.	Activities must be carried for the benefit of, or should be widely accessible to, the general public at large, including any sector thereof (other than small and exclusive groups).
The income and property of must not be distributable to its members or office-bearers except as reasonable compensation for services rendered.	The PBO cannot pay any remuneration, as defined in the Fourth Schedule, to any employee, office bearer, member or other person which is excessive, having regard to what is generally considered reasonable in the sector and in relation to the service rendered and has not and will not economically benefit any person in a manner which is not consistent with its objects
Report annually to the NPO Directorate.	Submit annual returns to SARS.
Must capture certain prescribed clauses in founding document, <i>cannot</i> sign written undertaking if clauses are absent.	Must capture certain prescribed clauses in founding document, but can sign written undertaking if those clauses are absent.
Does not grant legal status to entity. Only additional registration facility, but body corporate status confirmed in terms of NPO Act, except for trusts.	Does not grant legal status to entity, only offers tax benefit.
DIFFERENCES	
No tax benefits granted through status as registered nonprofit organisation. Minister may prescribe benefits.	Tax benefits granted once approved as public benefit organisation.

Registered in terms of Nonprofit Organisations Act of 1997.	Approved in terms of Income Tax Act of 1962.
Nonprofit Organisations Act of 1997 is exclusively dealing with NPOs and has only been amended once since it came into operation.	Income Tax Act of 1962 generally deals with the collection of revenue and not exclusively with PBOs and its gets amended almost every year.
Reporting documents of registered NPO available in terms of NPO Act to the public once submitted to the NPO Directorate.	Reporting documents of approved PBO not available in terms of Income Tax Act to the public. SARS operates according to secrecy clause in Income Tax Act.
Must annually submit prescribed narrative report and financial report certified by accounting officer. The NPO Act does not require registered NPOs to submit audited financial statements.	Must annually submit prescribed tax returns. The Income Tax Act does not generally require approved PBOs to submit audited financial statements. PBOs carrying on public benefit activities on Part II of the Ninth Schedule and on Part I which are not also on Part II are required to submit audited statements to show that receipts issued for donations in terms of section 18A have been used for that purpose.
Falls under auspices of Minister of Social Development.	Falls under auspices of Minister of Finance.
NPO Registration most often a requirement to access government funding.	PBO approval and s18A status most often a requirement to access corporate funding.
Registered NPO must, upon dissolution, transfer assets to another nonprofit organisation with similar objectives. The other NPO not required to be registered.	Approved PBO must, upon dissolution, transfer assets to another PBO, parastatal carrying on public benefit activities or an organ of state.
The NPO Act is aimed at creating an enabling environment for non-profit organisations and to promote public accountability. This was especially important for voluntary associations which did not have public facility to register. Most community-based organisations are legally established as voluntary associations and the NPO Act provided a registration facility for such organisations.	The relevant provisions in the Income Tax Act (section 10(1)(cN), section 30 and section 18A) are aimed at providing organisations that are carrying on public benefit activities – with some form of tax relief as those organisations are helping the government to fulfil its task. It also serves to encourage donors (corporates and individuals) to support the activities of such organisations by providing them with tax deductions for donations made.
One of the objectives of the NPO Act is to encourage NPOs to maintain adequate standards of governance, transparency and accountability and to improve those	Changes to the Income Tax Act were made after the South African state commissioned the 9th Interim Report of the Katz Commission of Inquiry which

<p>standards. The NPO Act is supposed to provide to provide a transparent environment where the affairs of registered NPOs can be scrutinised in order to promote public accountability. This presumably explains why NPO registration has become an almost automatic requirement for government funding. The same openness is not present with the PBO approval process.</p>	<p>made some important findings recommendations regarding the taxation of NPOs in South Africa.</p>
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