



Blending Profit & Purpose:

Social Enterprise, Impact Investing
and the South African Non-Profit Income Tax Regime

Robert Hare | Doctoral dissertation in progress



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INTRODUCTION

This leaflet aims to provide an overview of research I am currently conducting on the South African income tax regime governing charitable non-profit entities.

It summarises the scope of my research. The research is carried out in the context of a dissertation being drafted as a requirement for a Doctoral degree, in the Department of Commercial Law at the University of Cape Town (supervised by Professor Johann Hattingh).

Comments, suggestions and queries are warmly invited. Please refer to my contact details provided at the end of this leaflet.

A copy of this leaflet and my poster will be made available online at: <https://tax.uct.ac.za/research/students>

FORMAL TITLE OF DISSERTATION

Whether the South African income tax regime governing non-profit entities should be developed, with reference to the concepts of social enterprise and impact investing, and relevant features and developments in selected foreign jurisdictions

SCOPE

The thesis is fundamentally concerned with the South African non-profit income tax regime. However, it is submitted that the questions considered, and findings made, should also be of interest for jurisdictions with similar non-profit income tax regimes; and funders or investors (including high net worth individuals) interested in the achievement of social or environmental goals in a sustainable manner.

Non-profit entities may apply to the South African Revenue Service for approval as ‘public benefit organisations’ (‘PBOs’)¹ (the most common tax-exempt status sought by ‘charitable’ non-profit entities in South Africa), or ‘small business funding entities’ (‘SBFEs’)² (a narrower tax-exempt status, available to non-profit entities that specifically provide funding to ‘small, medium and micro-sized enterprises’).³

The income tax policies and laws governing PBOs and SBFEs have developed in an ad hoc manner resulting in several challenges.⁴ These include uncertainty regarding the scope and nature of the trading activities that PBOs and

¹ In terms of s 30(3) of South Africa’s Income Tax Act 58 of 1962 (the ‘Income Tax Act’).

² In terms of s 30C(1) of the Income Tax Act *ibid*.

³ Section 30C(1)(b)(i) of the Income Tax Act *ibid*.

⁴ For example, regarding PBOs, see eg: Dennis M Davis *Report on the Public Benefit Organisation and the Tax System for the Minister of Finance* (2018) South Africa, *Davis Tax Committee* at 5, 20 and 22.

SBFEs may undertake, constraints and inconsistencies in relation to their fundraising abilities, and unclarity regarding their respective roles. At the same time, despite the acknowledged importance of the work undertaken by these non-profit entities,⁵ many struggle to achieve financial sustainability.⁶

South Africa's tax system adopts a traditional, 'all-or-nothing' approach with non-profit entities and for-profit entities: entities are expected to operate entirely or substantially on a non-profit basis, enjoying a full tax exemption in exchange for carrying on their publicly beneficial activities; or they are treated as operating entirely on a 'for-profit' basis, paying tax on their income and claiming tax deductions in respect of their business expenses.

However, some jurisdictions have moved away from this traditional, 'all-or-

nothing' approach. For example, the United Kingdom ('the UK') and certain other jurisdictions provide for 'hybrid' entities, or 'social enterprises', which must carry on a business *and* have a social purpose.⁷ Depending on the jurisdiction, these entities, or their funders or investors, may enjoy some degree of tax relief.

The idea that *non-profit* objectives can be pursued while undertaking *for-profit* activities, such as trading or investing, lies at the heart of the concepts of 'social enterprise' and 'impact investing'.⁸

A 'social enterprise' has been described as an entity whose, 'primary objective is to ameliorate social problems *through a financially sustainable business model*, where surpluses (if any) are principally reinvested for that purpose' (my emphasis).⁹ 'Impact investing' has been described as making, 'investments... *with*

⁵ Davis *ibid* at 1–2.

⁶ See eg: Mmabatho Maboya & Tracey McKay 'The financial sustainability challenges facing the South African non-profit sector' (2019) 15 *The Journal for Transdisciplinary Research in Southern Africa* 1 at 7-8; Lauren G Ker *The Concept of Social Enterprise: An Analysis of the Current Tax Environment and Proposed Enabling Tax Incentives to Aid the Social Enterprise* (unpublished M Comm thesis, University of Cape Town, 2014) at 29.

⁷ Regarding the UK, see eg: UK Government *Setting Up a Social Enterprise*, available at <https://bit.ly/3STtbnZ>, accessed on 14 August 2022.

⁸ Regarding 'social enterprise' see, eg: Benjamin Means & Joseph W Yockey 'Introduction' in Benjamin Means and Joseph W Yockey (eds) *The Cambridge Handbook of Social Enterprise Law*

(2019) at 1. Regarding 'impact investing' see eg the Global Impact Investing Network's widely accepted conception of 'impact investing' below (note 10).

⁹ This is a 'working definition' of 'social enterprise' in South Africa, developed through research commissioned by the International Labour Organization ('ILO'). See eg: Susan Steinman *An exploratory study into factors influencing an enabling environment for social enterprises in South Africa* 1 ed (2010) South Africa, *International Labour Organization* at 40. Of the South African academic conceptions of 'social enterprise' considered to date, the ILO's working definition appears to be the most prominent and relevant for the purposes of the thesis, taking into account the following: the comparative volume of the ILO's research on 'social enterprise' in South

the intention to generate positive, measurable social and environmental impact alongside a financial return' (my emphasis).¹⁰ 'Impact investing' is, accordingly, a broad concept that could encompass a wide variety of investment structures, vehicles and instruments.

These concepts offer a different perspective of non-profit entities, suggesting that they could achieve greater financial sustainability, and be better positioned to perform their public functions, if they were permitted to adopt hybrid non-profit / for-profit models.¹¹ Accordingly, there have been several suggestions to amend or supplement South Africa's tax policies and laws, to accommodate the concepts of 'social enterprise'¹² or 'impact investing'.¹³ However, almost none of these suggestions have emanated from South African legal scholarship.

Against this background, the thesis applies the doctrinal legal method to

consider: (i) whether it is desirable to amend the income tax laws governing PBOs and SBFES so that they are better positioned to achieve financial sustainability and perform their respective public functions; and, subject to the findings in this regard, (ii) whether it is desirable to amend South Africa's Income Tax Act¹⁴ to provide for a hybrid 'social enterprise' entity. Any potential amendments in this regard will be informed by the principles, rules and concepts comprising the South African non-profit income tax regime itself; and developments relating to non-profit entities, 'social enterprise' and 'impact investing' in selected non-South African jurisdictions.

The findings in relation to questions (i) and (ii) will be evaluated against their coherence with the existing South African non-profit income tax regime; and with reference to other features of good tax

Africa, beginning in 2010; its engagement with legal and tax considerations (albeit by non-legal scholars), which is aligned with the focus of the research question and application of the doctrinal legal method; and the ILO's partnership with the South African government in preparing the 2021 Draft Green Paper on the Social and Solidarity Economy (Department of Trade, Industry and Competition (DTIC) *Draft Green Paper on the Social and Solidarity Economy* (2021), available at <https://bit.ly/3WyBeYm>, accessed on 20 December 2022).

¹⁰ The Global Impact Investing Network (GIIN) 'What is impact investing?' available at

<http://tinyurl.com/3uxntj24>, accessed on 11 January 2024.

¹¹ Maboya & McKay op cit note 6; Ker op cit note 6 at 64-5.

¹² See eg: *Draft Green Paper* op cit note 9 at 19; Steinman op cit note 9 at 93-4; Ker op cit note 6 (see ch 6 in particular).

¹³ See eg: Badri Zolfaghari & Geraldine Mary Hand 'Impact investing and philanthropic foundations: strategies deployed when aligning fiduciary duty and social mission' (2021) *Journal of Sustainable Finance & Investment* 1 at 19, 21 and 22.

¹⁴ Income Tax Act supra note 1.

policy, eg:¹⁵ equity, economic efficiency (including the role and desirability of tax incentives), and administrability. It may be appropriate to refer to or emphasise different features, or utilise different methods of developing tax policy, in a South African context or in the context of a non-profit tax regime. However, considering the limited South African tax and legal research dealing with non-profit entities, it is anticipated that this aspect of the thesis will also draw on research from non-South African jurisdictions.

At this point in the research, the UK, the European Union, and the United States have been identified as jurisdictions with comparatively advanced policies or laws, and tax or legal literature, dealing with non-profit entities, ‘social enterprise’ and ‘impact investing’. However, it is expected that future research will focus on developments in the UK, owing to certain relevant similarities between the UK and South Africa;¹⁶ with developments in other jurisdictions being considered as may be appropriate.

Robert Hare is an admitted attorney in South Africa (currently non-practising). Prior to commencing his doctoral research, Robert practised for over a decade in the South African tax practice group of Bowman Gilfillan Inc (‘Bowmans’).

Robert holds Bachelor of Business Science (Law) and LLB degrees from the University of Cape Town, a Postgraduate Diploma in Tax from the University of Johannesburg, and an LLM degree from the University of Chicago.

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¹⁵ Pasquale Pistone, Craig West, João Félix Pinto Nogueira et al *Fundamentals of Taxation: An Introduction to Tax Policy, Tax Law and Tax Administration* (2013) at 9–26.

¹⁶ For example, between their legal systems, particularly as regards company law, see eg: Oliver

D Schreiner *The Contribution of English Law to South African Law; and the Rule of Law in South Africa* The Hamlyn Lectures: Nineteenth Series (1967) 24 (and in general), R C Williams ‘Companies Part 1’ in Mandy Kühne (ed) *The Law of South Africa* 2 ed vol 4(1) (2012) para 3.