



THE COMPANIES ACT OF 2008

By Ricardo Wyngaard

ABOUT NPO LEGAL

ISSUES:

This is an electronic newsletter published by:
RICARDO WYNGAARD ATTORNEYS which is aimed at updating the non-profit sector on relevant legal issues.

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- The new nonprofit company defined.
- The power to expel a member of a voluntary association.

RICARDO WYNGAARD ATTORNEYS is a newly-established law practice that specialises in rendering legal advice and assistance on non-profit law and governance.

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Article One: Defining the new non-profit company

Former President Kgalema Motlanthe signed the Companies Act, No. 71 of 2008 (the Act) into law during April this year. The Act is not yet in operation and is expected to come into operation during July 2010.

The Act will notably improve the manner in which non-profit companies are incorporated and regulated. *NPO Legal Issues* will publish a series of articles on the key features of the non-profit company (the NPC) under the Act. The series starts by looking at how the NPC is defined.

Section 1 of the Act provides for a two-part definition of the NPC. The first part deals with the objects for which the NPC can be incorporated, namely: a public benefit object or an object relating to one or more cultural or social activities, or communal or group interests. The second part of the definition deals with the non-distribution constraint that is inherent with non-profit entities.

Eligible objects for the non-profit company

The NPC can be incorporated for the public benefit or to serve communal or group interests. The Act abandoned the list of objects contained in section 21 of the Companies Act of 1973 (the current Act). This list includes the objects of promoting religion, arts, sciences, education, charity and recreation. All these objects (except recreation) are now captured under the term public benefit. The Act has however retained reference to objects promoting cultural or social activities or communal or group interests as contained in the current Act.

What is meant by 'public benefit'?

The term 'public benefit' is not defined in the Act. The term is not new in the South African legal system. It has already found a place in the Income Tax Act with the introduction of public benefit organisations and public benefit activities during 2001. The definition of public benefit organisation in the Income Tax Act requires that the public benefit activities should be carried on 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). This may be a useful reference point to interpret what is meant by 'public benefit' under the Act.

This does not mean that NPCs with a public benefit object would automatically qualify as public benefit organisations under the Income Tax Act. The Companies Act deals with incorporation whilst the Income Tax Act deals with taxation. The NPC with a public benefit object must demonstrate compliance with the additional requirements laid down in the Income Tax Act in order to obtain tax benefits.

Countries are increasingly making use of the term 'public benefit' for purposes of determining whether or not non-profit organisations should qualify for tax benefits. Usage of this term elsewhere has however not been without controversy.



FROM THE COURTS:

Matlholwa v Mahuma [2009] ZASCA 29

By Ricardo Wyngaard

Earlier this year the Supreme Court of Appeal (the SCA) issued a ruling that is significantly important for the non-profit sector. In the matter of *Matlholwa v Mahuma [2009] ZASCA 29* the SCA had to decide whether a political party lawfully expelled one of its members. Three important principles came out this court decision:

1. Firstly, the SCA restated that a political party is a voluntary association which is founded on the basis of mutual agreement. In other words, a constitution of a voluntary association is actually a contract between its members.
2. Secondly, the SCA found that expelling a member from a voluntary association is 'the most drastic form of punishment' to inflict on a member. The constitution must expressly or by necessary implication provide the association with the power to expel a member.
3. Thirdly, if a member is expelled without a clear and unambiguous power to do so, it is unlawful.

In this particular case the SCA found that the expulsion of the appellant by the political party was unlawful because the internal committee that expelled the appellant was not authorised or empowered to do so. Key legal questions that voluntary associations should ask:

- Is the organisation operating within the boundaries laid down by its constitution?
- Is the organisation's constitution being reviewed on a regular basis?
- Does the organisation's constitution provide the organisation with a clear right to expel a member?
- Are new members provided with a copy of the organisation's constitution when joining the organisation?

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For example, in the United Kingdom, the advancement of education is no longer presumed to be for the public benefit under the Charities Act of 2006. The element of public benefit must be demonstrated by the charity. This is largely due to the term 'public benefit' being linked to tax benefits in that context. It is unlikely that this kind of controversy would find its way within the Act as it is dealing with incorporation, not taxation. NPCs without a public benefit object can still be incorporated for communal or group interests.

Can recreational clubs incorporate as NPCs?

Recreational clubs would more likely be covered under the objects relating to social activities or group interests. It is questionable whether recreational clubs would be construed as a NPC with a public benefit object. The Income Tax Act also draws a distinction between public benefit organisations and recreational clubs for purposes of taxation.

What is meant by the non-distribution constraint?

The second part of the definition of a NPC requires that the income and property of the NPC must not be distributable to its incorporators, members, directors, officers or persons related to any of them except as allowed for in terms of the Act. The exceptions would include: reasonable remuneration (for services actually rendered or goods delivered) or reimbursement (for expenses incurred to advance the NPC's objects); payment in respect of a bona fide agreement, legal obligation or enforceable rights (administered by the NPC). In essence, this means that NPCs cannot distribute their income and capital in the same way as profit companies. It must use such income and capital to advance its designated objects.

What is different from the current Act?

A notable improvement from the current Act is the fact that the NPC is no longer deemed to be a public company. In terms of section 19 of the current Act all section 21 companies are deemed to be public companies. This meant that section 21 companies are required to comply with all the provisions in the current Act that applied to public companies, except where it involved issues around shares. The new Act still makes provision for public companies, but non-profit companies are, thankfully, not deemed to be public companies.

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CAN TAX BENEFITS BRING RELIEF FOR NPOs?

By Ricardo Wyngaard

The South African Revenue Service (SARS) published the Taxation Laws Amendment Bills, 2009 during September 2009. The Bills have gone through a process of public comments during June this year. SARS published a Final Response Document containing their responses to the policy issues raised during the public comment process. It appears from the Final Response Document that the public process did not raise any NPO-related matters. It looks as if non-profits have become disengaged with tax issues at a policy level. If this is true, the non-profit sector may have forsaken an important avenue that could potentially alleviate some of the financial effects of the global economic crisis.

At least two important interventions, at a tax level, can potentially influence the financial situation of non-profits in South Africa. First, the possibility of increasing the existing 10% limitation on tax deductible donations (made under section 18A of the Income Tax Act). Section 18A has no doubt significantly changed the face of corporate giving in South Africa. Prior to the overhaul of the tax laws affecting NPOs that came into operation during 2001, corporate giving has not been widely prominent in South Africa. Increased tax incentives changed this situation. Corporate giving has grown progressively since then. Trialogue, in its 11th Edition of the CSI Handbook, states that, "...the total expenditure on corporate social investment in South Africa for the 2007/8 financial year amounted to R4.1 billion. In nominal terms, this figure is 29% higher than the R3.2 billion for the 2006/07 financial year,...". Increased incentives may lead to increased corporate and individual giving. Kenya has, for example, in 2007 through its Income Tax (Charitable Donations) Regulations introduced a 100% deduction on cash donations to tax-exempt non-profit organisations.

Second, those wanting to set up foundations in South Africa are not encouraged, from a tax perspective, to build up endowment funds. This is because 75% of donations received by funding public benefit organisations, which qualify for deductions under section 18A of the Income Tax Act, must be distributed in the next year of assessment - or the obligation to distribute must have been incurred. The Commissioner for SARS may waive this requirement, but SARS has already indicated that this requirement will not be waived to build up an endowment or capital fund. The reasoning behind this is not clear. The elimination of this requirement can certainly contribute towards the establishment and sustainability of foundations (and ultimately their beneficiaries).

Tax changes like these are unlikely to be initiated by SARS. NPOs will have to engage SARS & National Treasury to ensure that tax legislation and policy are continuously looked at to further promote their financial sustainability.



*STUDY TOUR:
Delegates from Uganda,
Kenya and Tanzania
meeting with officials
from SARS during a
study tour that took place
in July 2009. RWA
organised the local
arrangements on behalf
of the AGA Khan
Foundation.*

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