



## Tax deductibility of Corporate Social Responsibility/ Investment (CSI) expenditure

Is it correct for business not to claim tax deduction for costs incurred on CSI because they did not donate the money to an approved PBO with a section 18A receipt? I think it is not correct. Let's explore this issue as I try to show that these expenses ought to be claimed as tax deductions even if not donated to an approved PBO. As with all tax matters, these costs will only be deductible if the business meets the legislative requirements.

Businesses participate in community activities and projects by allowing their employees mentor local school children and small businesses, paint schools and crèches, work at soup kitchens, give money to local Non-Government Organizations (NGO), give bursaries to disadvantaged children, etc. They do all these in part because they want to earn corporate social investment (CSI) points for Broad Based Black Economic Empowerment (B-BBEE) rating. Some do it, and were doing it before B-BBEE legislation, as good corporate citizens. They give money to local PBO's or NGO's, usually to approved PBO's who issue a section 18A certificate/ receipt. This allows the business to claim the monies given to the PBO as a tax deduction. But shouldn't all these costs, irrespective of whether they were given to an approved PBO or not be allowed as a tax deduction, an expense incurred in the production of income not of a capital nature, and incurred for purposes of trade?





Generally, in deciding whether money outlaid by a taxpayer constitute expenditure incurred in the production of income (in terms of the general deduction formula) important and sometimes overriding factors are the purpose of the expenditure and what the expenditure actually effects; and in this regard the closeness of the connection between the expenditure and the income-earning operations must be assessed<sup>1</sup>. Income is produced by the performance of a series of acts, and attendant upon them are expenses. Such expenses are deductible expenses, provided they are so closely linked to such acts as to be regarded as part of the cost of performing them<sup>2</sup>. No deduction shall in any case be made in respect of any moneys, claimed as a deduction from income derived from trade, to the extent to which such moneys were not laid out or expended for the purpose of trade<sup>3</sup>. An expense incurred which is closely linked to the income earning activities of the business, expended for purposes of trade, is tax deductible. Two tests must be met before expenditure or losses can be deducted, expenditure must be closely linked to income producing acts and must be expended for trade.

What are income earning activities or series of acts performed to produce income? These are not limited to direct activities only – for example purchased aluminum or steel for manufacturing a BMW – but include all necessary costs to manufacture and sell the car. The manufacturing costs are easy to assess as compliant with income tax legislation. It is the other costs – selling and administration costs – that present difficulty and that CSI costs at times are a part of and at times are to comply with legislation.

The process of selling products or services is complex and diverse. Consumers demand and expect companies that they consume their products to deliver good quality products or services and act in a socially responsible manner<sup>4</sup>. The public's expectation of corporations has come a long way from the profit-centric models of the past 30 years. Today, 91% of the global population wants to see businesses do more than just make a profit. 88% of consumers want to engage with brands that put a premium on


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<sup>1</sup> Ticktin Timbers CC v Commissioner for Inland Revenue 1999 (4) SA 939 (SCA)

<sup>2</sup> Port Elizabeth Tramway Co Ltd v CIR (1936 CPD), 8 SATC 13

<sup>3</sup> Income Tax Act No. 58 of 1962, section 23(g)

<sup>4</sup> <https://www.forbes.com/sites/forbesagencycouncil/2020/07/31/corporate-social-responsibility-consumers-will-remember-companies-that-led-in-2020/?sh=6a762f3aeb65>



Corporate Social Responsibility (CSR). Businesses that learn this lesson have flourished. Businesses that don't have lost market share or even failed. This will continue to be the case if businesses don't take steps to become better corporate citizens. With demand for businesses to do more than succeed for themselves increasing across party and generational lines, it is imperative for businesses to seek out opportunities to align themselves with causes that boost their CSR. In addition to quality and price, the benefits a corporation provides to society is quickly becoming another pillar of the business world<sup>5</sup>.

As pressure is added by consumers seeking to make more responsible choices and by the constraints of ever-dwindling natural resources, more companies are incorporating sustainable strategies and adopting more socially responsible practices. Corporate social responsibility, or CSR, is the business practice of pursuing social and environmental gains, alongside financial gains. As the push for companies that do good increases, corporations of all sizes are looking for ways to incorporate sustainable business practices into their everyday. Some of the most popular CSR trends in the area of corporate social responsibility include increased transparency, investment in green technologies, local community and employee engagement, and diversity and inclusion initiatives.<sup>6</sup>

Acting in a socially responsible manner while trying to make profit is hard for companies to achieve and to claim tax deductibility of expenses incurred in this regard. This is where the CSI costs are incurred. The part of building character and positioning of the brand as socially conscious and a good corporate citizen. It's these costs that deliver on part of the consumer's expectation and are part of costs incurred to make a sale. Selling costs are not limited to salaries of the sales team, their client entertainment (excuses to go mountain biking in Drakensberg or participate in Cape Epic which are tax deductible), they include costs to build and sustain a chosen policy principle that builds the businesses character and identity.

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<sup>5</sup> <https://wethinkitmattersinc.com/the-demand-for-corporate-social-responsibility-csr-in-todays-economy/#:~:text=88%25%20of%20consumers%20want%20to,learn%20this%20lesson%20have%20flourished.&text=In%20addition%20to%20quality%20and,pillar%20of%20the%20business%20world.>

<sup>6</sup> <https://www.investopedia.com/ask/answers/011215/what-are-top-trends-corporate-social-responsibility.asp>



Toyota sells its Prius brand, an expensive vehicle for its size and abilities, as an environmentally friendly car given the current available technologies<sup>7</sup>. This is also the same message that Tesla sells to its customers. Buyers of these products support the companies for the initiatives they are taking in trying to limit carbon emissions. L'Oréal, the French cosmetics company, markets various products on the basis that they were not tested on animals and also spends money publicizing the activities it engages in to save water, recycle it and help communities where it operates<sup>8</sup>. These activities communicate to consumers the nature of the business and its character, they attract and retain consumers who value and are willing to support such initiatives. In building this character and brand, various costs are incurred. These various costs are part and parcel of engaging in business in the 21<sup>st</sup> century. They are no different to buying aluminum to manufacture a car.

Moneys expended by a taxpayer from motives of pure liberality fail to qualify as expenditure in the production of income<sup>9</sup>. It is quite easy to mistake the purpose of an act for its consequences...The consequences of an act often proclaim its purpose. After all, a person is presumed to have intended the natural consequences of his acts...It is true that the link between the appellant's trade and the social responsibility expenditure is not as close and obvious in the second category as in the first, but that does not mean that the connection is too remote. To qualify as moneys expended in the course of trade, an outlay does not itself have to produce a profit...A loss of the appellant's subsidiary status might have directly brought about the loss of all kinds of trade advantages. It was unthinkable that the appellant should not comply with the Sullivan Code at all. It was not certain what would become of it if it complied but failed to do so adequately; but the appellant was not obliged, and if the truth be told

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<sup>7</sup> [https://live-media.toy-backend.co.za/pdfs/brochures/Prius\\_Brochure.pdf](https://live-media.toy-backend.co.za/pdfs/brochures/Prius_Brochure.pdf), page 10: The Prius is specifically designed to minimise its carbon footprint through smart eco-exterior attributes and a hybrid engine that's globally-recognised for unmatched fuel economy, reduction in energy usage and overall efficiency in limiting CO2 emissions. The use of recyclable materials is central to Toyota's stance on environmental responsibility. Highly-recyclable plastics, uniquely designed to dismantle easily, are used extensively in the Prius, featuring in the majority of its interior and exterior components. At Toyota, creating technologically-advanced vehicles isn't our only priority; we are committed to lowering our environmental impact throughout our entire production process. How? By setting ourselves six challenges that will see us reach a truly world-changing goal: a positive environmental impact by 2050.

<sup>8</sup> <https://www.loreal-paris.co.za/our-efficacy>

<sup>9</sup> Commissioner for Inland Revenue v Pick 'n Pay Wholesalers (Pty) Ltd 1987 (3) SA 453 (A)



would not have been permitted, to take the risk of finding out. The Sullivan Code expenses were bona fide incurred for the performance of the appellant's income producing operation and formed part of the cost of performing it. The social responsibility expenditure was therefore incurred for the purposes of trade and for no other<sup>10</sup>. Warner Lambert was compelled to comply with the Sullivan Code principles,

which provided for the non-segregation of races in the workplace, equal and fair employment for all employees, equal pay, development of training programmes, increasing the number of disadvantaged persons in management and supervisory positions and improving the quality of employees' lives outside the work environment. These costs were held to be tax deductible. They are the same as various CSI costs incurred by business today.

In South Africa the B-BBEE Act compels businesses to engage in various activities that it will be assessed and rated on. Obtaining a high B-BBEE rating is important for businesses to conduct business with government and other businesses that want to achieve a high B-BBEE rating. The B-BBEE Act allocates points for costs incurred on corporate social investment programs. Thus, businesses incur these costs to be able to earn these points and get a better B-BBEE rating in order to attract more business from government and other businesses that seek to improve their B-BBEE rating. Most businesses spend their CSI budgets on approved PBO's in order to guarantee tax deductibility. The services rendered by the PBOs include feeding the elderly, math and science extra lessons to disadvantaged youths, feeding schemes, etc. Most businesses allow their employees to volunteer and assist in these programs but do not house such programs inhouse and limit the support they give to unapproved PBOs. However, there are businesses that incur costs to feed a local community, deliver food parcels to indigent people, actively engage in painting a local creche or school, donate textbooks, shoes or stationery to their local schools, etc. They don't outsource these services to PBOs. They do this to comply with B-BBEE legislation but also like Toyota, Tesla and L'Oreal, as good corporate citizens building their character and their brand. It is not out of pure liberality but to make sales. They are active participants in their local communities. Viewed in this light, it appears absurd that a discussion on the tax deductibility of costs incurred to comply with legislation and to build a brand should be perceived by businesses as nondeductible if not incurred through a an approved PBO.

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<sup>10</sup> Warner Lambert SA (Pty) Ltd v Commissioner for South African Revenue Service, 65 SATC 346

As an aside, there is a growing trend (if not an epidemic) in SA of NGO's that are too small and lack capacity to deliver on the promises they make. They are spurred on by the prospect of being sponsored by businesses to meet CSI obligations.

Mining companies must comply and deliver on their approved social and labour plans. These plans normally include activities to support local communities with training, health, food, etc. Mining companies have to comply with regulations that require these plans but they do them as good corporate citizens. The difficulty that costs incurred to deliver on these plans are at times perceived by accountants of the business as not incurred in the production of income. As a result, the mining business seeks approved PBO's to donate to, on the promise that the PBO will deliver the said services. They hand over their responsibility and end up dealing with lots of competing interests by PBO's seeking to secure donations. This leads to unconsolidated delivery structures for the social and labour plans and unimpactful small projects undertaken. Clarity and unquestioned deductibility standing of these costs may result in better structured projects by the businesses leading to better social outcomes for the affected communities.

Here are some extracts on how businesses see their CSI responsibilities and they clearly seem them as business imperatives:


Microsoft – This extract comes from an article in top-employers.com, a publication that issues annual awards for best employers – a way for companies to attract top talent (future employees) to their companies based on what the company represents, its ethics, culture and human resource policies.

Partnering to bring together resources that have the power to reimagine how people learn and apply new skills to prepare for the workplace of the future, as well as create opportunities to equip unemployed South Africans with much-needed digital skills is a priority for Microsoft.

“Our goal is to combine the best in technology with stronger partnerships with organisations like LinkedIn, GitHub and Afrika Tikun (*a non-profit company providing work readiness programs and skills development to under privileged communities, also provides nutrition and health needs*) to help empower people to develop the skills needed to secure a new job. We are, for instance, encouraged by our learning partners who are offering access to their classroom facilities and devices for unemployed people to book training and use the facilities at no cost, and are excited to continue collaborating with partners to provide expanded access to digital skills,” concludes Siya Madyibi, corporate affairs director at Microsoft South Africa<sup>11</sup>.

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<sup>11</sup> <https://www.top-employers.com/en-ZA/insights/learning-development/microsoft-digital-skills/>



The Black Business Quarterly issues an award, CSI Ubuntu Award<sup>12</sup> to a business that has evidence of social responsibility in areas that include socio-economic development initiatives, projects or programmes in education, community development, job creation and skills development and contributing to public and community development and the stability of our nation. In 2020 this award was issued to AECI. Nicole Solomon, CSI Manager, on accepting the award, said, "We take transformation and community development very seriously and just keep making a difference and impact in the communities around where we operate is very important to us. We see ourselves as a business with purpose"<sup>13</sup>.

An extract from South 32 Limited CEO's report on the 2020 financial statements, reads:

In FY20 we continued to implement community investment plans at all operations and invested US\$24.5 million in community initiatives and activities. We developed a framework to measure and enhance the impact of our investments across the areas of education, economic participation, health and social wellbeing, and natural resource resilience. We also provide disaster relief in times of crisis for our communities and in FY20 we donated A\$1 million to support relief efforts linked to the Australian bushfires. Wherever we operate, we engage the local Indigenous communities and ensure that site work programs take account of areas of cultural significance and the views of our traditional and local communities. In late FY20, we commenced a review of our approach to cultural heritage management to identify any opportunities to strengthen or enhance our systems and processes. In Colombia, we transferred over 390 hectares of land to seven Indigenous Councils of the Zenú community and the Black Community Council of Bocas de Uré for sustainable agriculture.

And the Chairperson, Karen Wood, said:

At Cerro Matoso in Colombia, following extensive engagement with community and government institutions, we reached agreement with 15 groups including seven Indigenous, two Afro-Colombian and six non-Indigenous communities covering engagement, investment and environmental management. These agreements build on our positive relationships in the region and provide a strong foundation to work in partnership to create healthier and stronger communities. We know we can only be successful when communities and broader society share in the benefits of what we do. We have continued to support our communities with investments of US\$24.5 million focused on four key areas aligned to community need: education and leadership, health and social wellbeing, economic participation, and natural resource resilience<sup>14</sup>.

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<sup>12</sup> <http://www.bbqawards.co.za/awards>

<sup>13</sup> <https://www.youtube.com/watch?v=7px7EXRhMhY>

<sup>14</sup> [https://www.south32.net/docs/default-source/sustainability-reporting/fy20-sustainability-reporting/2020-annual-report.pdf?sfvrsn=2f82e7cf\\_6](https://www.south32.net/docs/default-source/sustainability-reporting/fy20-sustainability-reporting/2020-annual-report.pdf?sfvrsn=2f82e7cf_6)

These extracts indicate how business perceives their responsibilities and how they act in order to achieve or deliver on these responsibilities. They are very similar to the Sullivan Code principles and are in more ways similar to the principles of the B-BBEE Act.

Businesses see their participation in CSI as part and parcel of doing business and generating income. Their success is dependent not only on the efficiencies and competitiveness of their products but also on how they participate in local community initiatives and programs. These initiatives and programs are part of the operations, are budgeted for, are expected by local communities and enhance the ability of the business to operate within a specific area and environment.

These expenses are incurred in the production of income and for purposes of trade. They are not benevolent expenses incurred out of pure liberality. 21<sup>st</sup> century businesses understand this and are doing it, to comply with legislation and because they recognize the benefit of doing same on the bottom line. How these costs are expended should not influence their tax deductibility. Businesses should not be restricted to funding PBO's to do the work they can do to benefit society and enhance their brands. They ought to do this and obtain the tax deduction without going the PBO route. They should maximise their own brands and public participation because their communities notice, the public notice and their income earning operations benefit when everyone notices.

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