

*Full Length Research Paper*

# The income tax deductibility of indirect empowerment measures relating to Black Economic Empowerment (BEE) in South Africa

Tim Acker<sup>1</sup> and Rudie Nel<sup>2\*</sup>

Department of Accounting, Stellenbosch University, Private Bag X1, Matieland, 7602, South Africa.

Accepted 4 July, 2013

When an entity incurs expenditure relating to indirect empowerment measures of broad-based black economic empowerment ('BEE') (that is the preferential procurement, enterprise development, skills development and socio-economic development categories on the BEE scorecard), there are differing opinions on whether or not these expenditure will be deductible in terms of the South African Income Tax Act. The current study considered types of expenditure and the reasons for incurring expenditure towards indirect BEE empowerment measures. Four issues were identified that could preclude a deduction in terms of the general deduction formula (section 11(a)) – notably, that expenditure has to be in the production of income. The conclusions drawn as to the deductibility of expenditure are summarised as a best practice guideline for taxpayers. Even though expenditure towards indirect empowerment measures has been found to be deductible in most cases, there are exceptions. The study concludes with proposed best practice guidelines which could provide guidance in respect of the deductible of this type of expenditure.

**Key words:** Black economic empowerment (BEE), tax deductions, indirect empowerment measures.

## INTRODUCTION

Broad-based black economic empowerment ('BEE') was formally implemented by the South African government in 2003. Compliance with BEE is measured using a multifaceted scorecard mandated under a Code of Good Practice that is authorised by the Broad-Based Black Economic Empowerment Act 53 of 2003 ('the BBEE Act') (Department of Trade and Industry, 2007).

Entities are awarded a BEE rating from level 8 (favourable) to level 1 (unfavourable), based on compliance with seven categories as per the BEE scorecard. The seven categories of the score card can be divided into three direct measures and four indirect empowerment measures. The three direct empowerment measures involve metrics for, respectively, the number of qualifying

shareholders, managers and employees (Tucker, 2003). The indirect empowerment categories of the score card mostly involve an entity incurring some expenditure that indirectly empowers a previously disadvantaged person. These indirect categories include metrics for expenditure such as purchasing goods and services from other businesses with a good BEE score; financial contributions towards the development of qualifying businesses; skills development; and socio-economic development through contributions to social causes (Empowerdex, 2007c). This study is concerned with the latter four categories of the score card, meaning the so-called 'indirect methods' of empowerment (Table 1) and expenditure that fall under those categories.

\*Corresponding author. E-mail: rnel@sun.ac.za. Tel: +72 21 808 9097 / 072 407 6789.

**Table 1.** Categories of BEE expenditure.

<b>Direct empowerment measures</b>	<b>Indirect empowerment measures</b>
Ownership	Preferential procurement
Management	Enterprise development
Employment equity	Skills development
	Socio-economic development

Source: Empowerdex, 2009.

**Table 2.** Categories of expenditure relating to indirect empowerment measures.

<b>No</b>	<b>Broad categories of expenditure</b>	<b>Indirect empowerment measure</b>
1	General procurement expenditure	Preferential procurement
2	Charitable contributions to persons other than employees	Enterprise development and socio-economic development
3	Non-monetary assistance to persons other than employees	Enterprise development and socio-economic development
4	Monetary expenditure by employers towards skills development of qualifying employees	Skills development
5	Non-monetary assistance by employers towards skills development of qualifying employees	Skills development
6	BEE verification expenditure	Not applicable

Financial managers are often troubled by the tax deduction implications of spending on indirect empowerment measures, as such expenditure often does not directly influence the amount of profit made (Brincker, 2010). Various expenditures relating to BEE fall into said category, including, for example, those related to helping qualifying businesses start up, certain training expenditures, termination pay for non-qualifying employees, or general social responsibility spending.

### Research problem

The Broad-Based Black Economic Empowerment Amendment Bill, tabled in Parliament in 2012, proposes increasing the weightings of the indirect empowerment categories of the scorecard (Department of Trade and Industry, 2011). As indirect empowerment measures are set to become more important, the relevance of certainty regarding the tax implications of such expenditure also increases (Ngcobo, 2011). Furthermore, when an entity incurs expenditure relating to the indirect empowerment measures of BEE it might also be unclear whether such expenditure will be deductible for income tax purposes in terms of the Act (BEE Partner, 2008). Whilst the South African Revenue Service ('SARS') has given an

indication to certain taxpayers that they will allow such deductions in some cases, certainty regarding the matter is currently lacking (PwC, 2009a; SARS, 2009). PwC and KPMG have reached slightly incongruent conclusions regarding the matter. PwC (2004) holds the opinion that BEE expenditure will sometimes be deductible, but not in all cases. KPMG (2004) has stated that the expenditure related to BEE should be tax deductible in all cases. PwC (2009b) has also stated that socio-economic contributions (which are also one component of BEE) will be deductible, but only under 'appropriate circumstances'.

### Research objective and value

The objective of this article is to formulate best practice guidelines for the deduction of expenditure relating to the indirect empowerment measures of BEE. The best practice guidelines consist of factors that require consideration when determining whether such expenditure is deductible for income tax purposes. This objective would be achieved systematically using the following approach:

1. Considering the different categories of expenditure relating to indirect empowerment measures of BEE. The broad categories of expenditure in Table 2 are used

to organise the consideration of tax deductibility and related best practice guidelines;

2. Considering the tax deductions pertaining to the different categories of expenditure relating to indirect empowerment measures of BEE; and
3. Formulating the best practice guidelines in concluding on findings in the previous two steps.

The value of the research is contained in the guidance it could provide to taxpayers when doing their tax planning in incurring expenditure in respect of indirect BEE empowerment measures. The best practices guidelines could also assist entities that wish to increase, or to maintain, their BEE rating to do so in the most cost- and tax-effective manner possible. Providing clarity regarding tax deductions that are currently uncertain could also encourage entities to increase their level of corporate social investment and other socially beneficial expenditure (Thersby, 2006).

## RESEARCH METHODOLOGY

The research design of this study was non-empirical in nature using secondary data from existing literature. A literature review was performed to identify different views that currently exist on the deductibility of expenditure relating to indirect BEE empowerment measures. This literature review relied on the Scopus, EBSCOhost, Sabinet and Lexisnexis® databases to identify literature from tax, mercantile law and economic policy journals. The study also investigated publications by authorities in the field of tax and BEE, such as law firms, auditing firms, banks and BEE verification agencies, as well as BEE publications by the South African Department of Trade and Industry. As the objective of the study was to formulate best practice guidelines, popular media articles on the deductibility of expenditure relating to indirect BEE empowerment measures were also considered.

Guides by Empowerdex (2007a) and Bowman Gilfillan (2005), as well as other literature, were used to identify the common expenditures under each section of the scorecard. The different broad categories of expenditure relating to indirect empowerment measures were then formulated. The sections of the Act that could provide an income tax deduction for the different broad categories of expenditure towards indirect empowerment measures were then investigated. The next step was to apply the principles of the Act and case law to the facts and circumstances surrounding expenditure on indirect empowerment measures and to formulate related best practice guidelines. In evaluating whether expenditure relating to indirect empowerment measures is deductible, the article did not seek to provide an exhaustive dichotomy of all those expenditures that can be deducted and all expenditure that cannot be deducted. The aim was rather to give a general overview of the factors that

require consideration when determining whether an expense is deductible for tax purposes.

## Different categories of expenditure relating to indirect empowerment measures of BEE

Some writers have considered the deductibility of BEE expenditure as a whole as the issue at stake (Tarrant, 2007), whereas others have also looked at specific BEE expenditure per selected categories of the BEE scorecard (Ntombela, 2006). It is submitted that the tax deductibility of expenditure relating to indirect empowerment measures has to be considered separately for different kinds of expenditure and in different situations as the nature of the different expenditure will differ and could affect the deductibility for income tax purposes. An examination of BEE literature renders several examples of expenditure that could be incurred in each category of indirect empowerment measures (Table 1): being, preferential procurement, enterprise development, skills development and socio-economic development. Each of these categories is subsequently discussed in order to summarise the most common expenditure in each category.

**Preferential procurement** points are awarded when goods and services are procured from businesses that have a BEE rating. The score calculation allows for a greater percentage of the procurement expenditure for buying from businesses with higher BEE rating levels (Standard Bank, 2008:16). The nature of the preferential procurement category of the BEE scorecard is such that most general procurement expenditure would be included here (Empowerdex, 2007b). Examples include bank fees, insurance, rent, legal fees, raw material, most services and empowerment-related expenditure (Jack and Harris, 2007). It would, however, never be cost-efficient for an entity to incur expenditure with the primary aim of scoring points on their BEE scorecard under preferential procurement, due to the fact that the points concerned are calculated using a percentage of total procurement by the entity, as has been described above.

**Enterprise development** points are awarded based on the percentage of profit that is contributed to the growth of businesses that are owned by qualifying persons. An example of such contribution would be donating a vehicle to a qualifying person in order for him or her to start or to expand a delivery company. Points can be awarded for any non-monetary contributions that can be quantified, such as loans, guarantees, credit facilities, provision of training or the donation of an asset. The Codes of Good Practice includes examples such as direct expenditure or overheads incurred to assist a beneficiary entity or payments to third parties to perform enterprise development on its behalf (Bowman Gilfillan, 2005).

Enterprise development points can be awarded for the

giving of indirect benefits, such as training or mentoring (Department of Trade and Industry, 2005). The expenditures could generally be divided into two subclasses. Firstly, there are those that have a clearly defined monetary cost for the entity making the contribution, for example the donation of money, or the paying of expenses on behalf of the beneficiary. Secondly, there are contributions that do not have a direct monetary cost, or that do not cause incremental expenditure for the contributing entity. Such contributions would include discounting prices or using staff to provide mentorship.

**Skills development** points are awarded for the percentage of payroll spent on the training and development of qualifying employees. Legitimate expenditure includes the cost of trainers, materials, training facilities, course fees and others (South Africa, 2007). Qualifying expenditure types include programmes at schools and universities; certain recognised workplace training and some others (Standard Bank, 2008). Two broad categories of expenditure can be discerned in the above. Firstly, there are the majority of expenditures relating to training for employees that involve actual incremental expenditure for the employer. Secondly, there are those contributions that are not actual incremental expenditures for the entity, but which would still be included as an amount in the scorecard calculation. Such contributions would, for example, be amounts that are calculated as a percentage of payroll for time spent by employees presenting training.

**Socio-economic development** points are awarded for making donations to charity or for involvement in industry-specific charity initiatives. The points awarded are calculated based on the percentage of net profit after tax contributed (Standard Bank, 2008). Any contributions that are quantifiable would qualify for such points. Quantifiable contributions include loans, preferential prices, donations of funds or assets, direct expenditure and overheads incurred in assisting beneficiaries and mentoring of beneficiaries (Bowman, 2005). Two broad categories of contributions are recognised: charitable grants and contributions in the form of human resource capacity (Bowman, 2005). As is the case for the enterprise development category, non-monetary contributions that can be quantified qualify for points. Such quantification would include, for example, quantifying the value of staff time that is spent on charitable initiatives (Department of Trade and Industry, 2006).

A general expense related to all indirect empowerment measures is the annual fee paid to an accredited BEE verification agency to verify points awarded on the BEE scorecard (South Africa, 2008). Based on the consideration of the nature of expenditure above, six broad categories of expenditure were identified relating to the indirect empowerment measures (Table 2).

This section provided a non-exhaustive summary of common expenditure relating to indirect BEE

empowerment measures. The tax deduction for each category (Table 2) will now be considered in the section which follows, with the aim of formulating best practice guidelines.

## CONSIDERING THE INCOME TAX DEDUCTIONS

With reference to literature by PwC (2010), Wilcocks (2010a) and the Act, the following specific deductions were identified as possibilities for the deduction of expenditure relating to indirect BEE empowerment measures:

**Section 12H – Learnership allowance:** The allowance is a limited deduction for employers training employees through registered learnership agreements (Wilcocks, 2010b).

**Section 12I – Additional investment and training allowance:** The allowance is a limited deduction for investments and training related to qualifying Industrial Policy Projects. The applicability of the deduction is limited to approved projects in the manufacturing industry (PwC, 2010).

**Section 18A – Donations to public benefit organisations:** A limited deduction is available for donations to qualifying beneficiaries (Wilcocks, 2010a). This deduction can be utilised for qualifying donations (with the required documentation) as part of socio-economic development or enterprise development programmes (Jack and Harris, 2007).

**Capital allowances** include those made in terms of section 11(e), section 13 sex and section 15(a). In cases where SARS disallows expenditure for deduction under section 11(a), due to judging said expenditure capital in nature, a capital allowance could still be claimed. For example, providing an asset to a qualifying enterprise could be deductible under section 11(e).

If one of the aforementioned specific deductions does not apply, the general deduction formula could be considered in order to claim an income tax deduction. The general deduction formula is contained in section 11 of the Act and reads as follows: “*For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived – a) expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature...*”

To ascertain whether an amount is deductible in accordance with the general deduction formula of the Act, the requirements of section 11(a), read together with section 23(g), have to be considered (PwC, 2010). Acker (2012) concluded that expenditure related to indirect BEE measures potentially qualifies for deduction under section 11(a) of the Act, but identified four potential issues which preclude the possible deduction:

1. Only outlays of money or assets can qualify as expenditure or losses.
2. The test for 'in the production of income' is subjective and will not be passed in all cases. Acker (2012) concluded that expenditure, in principle, would not be in the production of income if it is excessive.
3. Expenditures incurred to meet certain categories of some sector charters might be capital in nature.
4. Expenditure incurred for general philanthropic purposes would most likely not be regarded as being incurred in the course of carrying on a trade. Ernst and Young (2011) confirmed with reference to the case of *CIR v Pick 'n Pay Wholesalers (Pty) Ltd* that philanthropic expenditure would not be deductible.

The test of whether expenditure is in the production of income is especially key when determining deductibility (Jack and Harris, 2007) and is therefore expanded upon in this section. Many of the sources referenced in the current study have mentioned that *Warner Lambert v C:SARS* strengthens the case for the deduction of expenditure related to BEE (Ntombela, 2006). According to KPMG (2004), the 'actual purpose' of expenditure towards BEE compliance has to be considered to decide whether the expenditure is incurred in the production of income. Common reasons for becoming BEE-compliant were therefore identified and evaluated to determine if they are in the production of income.

Based on the above considerations, the reasons for incurring BEE expenditure impact on any consideration as to whether the expenditure would be in the production of income. Furthermore, expenditure towards becoming BEE-compliant is likely to be incurred in the production of income, in most cases.

For each of the broad categories of expenditure (Table 2), the application of the possible specific deductions is considered as starting point, and then the potential issues identified by Acker (2012) are now considered in more details.

## GENERAL PROCUREMENT EXPENDITURE

None of the specific deduction provides for a deduction of expenditure under this category. The nature of the general procurement expenditure, which refers to preferential procurement expenditure, includes a range of both operational and capital expenditure. It is therefore not disputed that expenditure under this category would be deductible for income tax purposes. According to Kotze (2012), the above opinion is also supported by Mazars.

### Charitable contributions to persons other than employees

This broad category refers to expenditure incurred

towards the enterprise development and socio-economic development categories of the BEE scorecard. A section 18A deduction can be claimed where contributions are made to qualifying entities (Jack and Harris, 2007), provided that the donor obtained a valid section 18A receipt to substantiate such a deduction. If is not a qualifying donation in terms of section 18A, the general deduction formula (section 11(a)) could still be considered. In considering deductibility in terms of the general deduction formula (section 11(a)) the four issues which could preclude such deduction (Acker, 2012) should be considered:

1. The first issue that could preclude a deduction is that only outlays of money or assets can be regarded as 'expenditure or losses'. As the broad category of expenditure considered in the current section refers only to monetary outlays, it would qualify as expenditure or losses.
2. The reason for making a contribution towards enterprise development or socio-economic development determines whether the expenditure is made in the production of income. The common reasons for becoming BEE-compliant, along with a conclusion of whether those reasons qualify as being 'in the production of income', were summarised in Table 3 and can be applied here.
3. Expenditure towards BEE measures might be capital in nature, but taxpayers should be able to show, in most cases, that such expenditures are not capital in nature (Ernst & Young, 2011).
4. According to Williams (2009), expenditure towards BEE facilitates the carrying on of a trade. An exception where charitable contributions to persons other than employees will not form part of the carrying on of a trade is where said contributions are made purely for philanthropic reasons.

In summary, charitable contributions to persons other than employees should mostly be deductible under the general deduction formula, except for a few cases.

### Non-monetary assistance to persons other than employees

This broad category also refers to contributions relating to enterprise development and socio-economic development, but specifically only to non-monetary expenditure (typically contributions in the form of assets, providing discounts or using staff time for mentorship or charitable initiatives).

Except for contributions in the form of assets or quantifiable staff time, other expenditures under this broad category do not qualify as 'expenditure or losses' as per the general deduction formula (Van Schalkwyk, 2010). For contributions in the form of assets, the principles for deduction per section 11(a) are the same as those that

**Table 3.** Reasons for becoming BEE-compliant – whether they can be viewed as being in the production of income.

No	Common reasons for complying with BEE requirements	Whether the reason qualifies as being in the production of income
1	BEE required for public enterprises. Every organ of state and public entity is required to take into account and to apply 'as far as is reasonably possible' any Code of Good Practice issued under the BBEE Act.	Yes. Becoming BEE-compliant because of a legal obligation (with potential penalties) would qualify as being in the production of income.
2	Preferential procurement-related requirements and benefits. An entity wishing to tender for such contracts could increase its BEE rating and thereby win more contracts from government bodies and public companies (Arya and Bassi, 2011). Such is the case for any entity tendering for government work, as well as it is for any supplier to a business that is trying to increase its BEE rating (De Klerk, 2008).	<i>Yes, but only to the extent that it is not excessive.</i> For example, when an entity already has a level-1 BEE rating and incurs further expenditure, these excessive expenditures would not be in the production of income.
3	Marketing and public image. Marketing could be a motive for an entity to achieve an acceptable BEE rating (Jack and Harris, 2007). Ferreira and De Villiers (2011) have shown that there is a positive correlation between a higher BEE rating and share price.	Yes. An IQAD and KPMG (2010) study has shown that BEE compliance increases profits.
4	A commitment to transformation or general philanthropic reasons. Activities on the BEE scorecard, such as socio-economic development and enterprise development, are areas to which many entities contribute resources, regardless of BEE requirements (Matten and Moon, 2008).	No. The principle that philanthropic expenditure is not in the production of income was affirmed in <i>CIR v Pick 'n Pay Wholesalers (Pty) Ltd</i> (Ernst and Young, 2011).
5	Legal requirements for some entities. Two sector charters were issued as amendments to acts. These are exceptions where non-compliance could result in severe penalties (Mohamed and Roberts, 2008).	Yes. Entities that incur expenditure in order to avoid the loss of a mining licence would do so in the production of income, for instance.

apply for regular payments; therefore, refer to the section on charitable contributions to persons other than employees in said regard. Contributions in the form of staff time are also evaluated in the same way as the aforementioned category – the deduction will be quantified with reference to hourly rates (Jack and Harris, 2007). All payroll-related expenditure would, however, generally already be deductible, regardless of the fact that staff time is contributed towards BEE. When contributing staff time to indirect BEE measures, a deduction can only be claimed once (section 23B).

Section 18A can be used for donations of assets (but not for staff time spent), but only if the donations are made to qualifying beneficiaries (Jack and Harris, 2007).

### **Monetary expenditure by employers towards skills development of qualifying employees**

As previously explained this broad category of expenditure includes such skills development expenditure as bursaries to employees and accredited learning programmes. Expenditure related to skills development should often be deductible per section 11(a), regardless of whether it contributes to a taxpayer's BEE rating (Jones,

2009:2-4). The four issues that were identified as potentially precluding a deduction are now applied to this category of expenditure.

1. Expenses under this category will qualify as expenditure or losses.

2. In Table 3, it was seen that all the common reasons for becoming BEE-compliant qualify as in the production of income, except for the second reason (in some cases) and the fourth reason. This requirement was discussed in more detail in the section on charitable contributions to persons other than employees and applies similarly to the present category of expenditure. For example, expenditure incurred towards skills development of qualifying employees only for social good, rather than for it having any benefit to the business, would not be in the production of income.

3. The circumstances previously mentioned where expenditure might be capital in nature do not apply to skills development.

4. Skills development expenditure should mostly be related to the taxpayer's trade. In instances where this is not the case, the expenditure will also not be in the production of income, as it would have been incurred for general philanthropic purposes.

In summary, expenditure in this broad category will often be deductible purely because most skills development expenditure inherently qualifies for deduction under section 11(a). For those skills development expenditures that are not deductible in such a way, the second option is to consider whether they are deductible owing to their contribution to the BEE scorecard, as has been done above. An allowance can be claimed under section 12H when skills development activities are performed by means of registered learnership agreements (Woolley, 2005). Training expenditure that is related to a qualified Industrial Policy Project can be deducted under section 12I, but only up to a certain monetary limit per employee (PwC, 2010).

### **Non-monetary assistance by employers towards skills development of qualifying employees**

Expenditures under this broad category are those that score points under the skills development category of the BEE scorecard, but that are not cash expenditures. The only example given in the Codes of Good Practice of how such expenditure would be quantified is as a percentage of payroll for time spent on skills development (South Africa, 2007). Payroll expenditure would, however, almost always already be deductible under section 11(a). In the rare exceptions where payroll expenditure is not already deductible, the percentage that was allocated to BEE skills development will follow the same principles for deduction as per those already covered in the previous section. Section 12H and section 12I allowances can also be utilised for non-monetary expenditure in qualifying circumstances (Wilcocks, 2010b).

### **BEE verification expenditure**

This category of expenditure refers to fees charged by BEE verification agencies to verify the points awarded on a company's BEE scorecard. The four possible issues precluding a deduction of BEE verification expenditure are now considered.

1. Expenses for BEE verification qualify as expenditure.
2. All reasons for wanting to become BEE-compliant would qualify as being in the production of income, as summarised in Table 3. For example, even if an entity has only one client that requires a BEE rating, the entity still needs to have its scorecard verified (Steyn, 2011).
3. BEE verification expenditure forms part of operating an entity's income- operation, as it is an annually recurring fee that is paid to achieve BEE compliance (Bowman, 2005). The expenditure would, therefore, not be regarded as being capital in nature (Ernst and Young, 2006).
4. Verification expenditure occurs in the course of carrying on a trade, as an entity would only incur such

expenditure if it is beneficial (De Klerk, 2008).

Therefore, verification expenditure should be deductible in all cases. The conclusion drawn from the application of the general deduction formula (in a general sense) was that expenditures relating to indirect BEE measures are deductible, although there are four issues that can cause them not to be deductible. These four issues were considered to reach conclusions for every broad category of expenditure in the preceding subsections; the taxpayer's subjective intention will, however, have to be assessed in each individual scenario (Williams, 2009). These conclusions are now expanded in the next section to formulate best practice guidelines.

### **Formulating the best practices guidelines**

The deductibility of expenditure towards indirect BEE measures has first been considered in a general sense and then specifically for the identified broad categories of expenditure. Based on findings, it can be concluded that expenditure relating to indirect BEE empowerment measures should mostly be deductible per section 11(a) of the Act. Four potential issues were identified that could cause such expenditure to not be deductible; notable amongst these potential issues is the requirement that expenditure be in the production of income. The common reasons for becoming BEE compliant were identified in Table 3, together with whether they will qualify as being in the production of income. The consideration of the deductibility of expenditure under each broad category (refer preceding sections) can be utilised as best practice guidelines for entities planning on incurring expenditure in said categories. General best practice guidelines are now provided in the sections that follow Table 4.

### **Conclusion**

The objectives of this study were to determine whether expenditure relating to indirect empowerment measures of BEE is deductible and to formulate best practice guidelines for the deduction of such expenditure. Specifically, four issues were identified that could preclude expenditure towards indirect BEE measures from being deductible in terms of the general deduction formula (section 11(a)). In Table 3, the different reasons for entities incurring expenditure towards indirect BEE measures were submitted, as the reason for incurring expenditure can influence whether such expenditure is in the production of income (Van Schalkwyk, 2010). Of the common reasons for complying with BEE requirements, it was found that only expenditure that is excessive or that is incurred for philanthropic purposes would not be regarded as being incurred in the production of income (Table 3).

Table 4. Best practice guidelines.

No	Broad categories of expenditure (including specific guidelines)	General best practice guidelines
1	<ul style="list-style-type: none"> <li>-General procurement expenditure</li> <li>-No specific guidelines.</li> </ul>	<ul style="list-style-type: none"> <li>• Documentation, such as an invoice or internal accounting record, is required for the BEE scorecard and for any deduction per section 11(a). Additional documentation could be required to prove the taxpayer's intention of producing income.</li> </ul>
2	<ul style="list-style-type: none"> <li>-Charitable contributions to persons other than employees</li> <li>-Specifically problematic areas are expenditure that is excessive or that is incurred for philanthropic purposes, in which case apply general best practice guidelines.</li> <li>-Expenditure that is capital in nature is not deductible per section 11(a), but has possible capital allowance implications.</li> <li>-Section 18A requires certain documentation.</li> </ul>	<ul style="list-style-type: none"> <li>• Onus to prove that incurred in production of income (on taxpayer per section 82):</li> <li>- Only deductible if intention to produce income can be proved.</li> <li>- Example of proving intention: documented minutes of board meetings; proof that philanthropic work led to new contracts; a written BEE policy; a strategy of how compliance with BEE will translate to future profits; the management of BEE expenditure as a cost centre; or active marketing of its BEE status.</li> <li>- Expenditure incurred towards 'fronting' is not deductible.</li> </ul>
3	<ul style="list-style-type: none"> <li>-Non-monetary assistance to persons other than employees</li> <li>• Quantify non-monetary assistance at fair value.</li> <li>• Section 23B prohibits multiple deductions for one expenditure, such as payroll expenditure already deducted.</li> <li>• Section 18A requires certain documentation and is only allowed for donations of cash or property in kind (therefore not staff time).</li> </ul>	<ul style="list-style-type: none"> <li>• Excessive expenditure towards BEE is not deductible. Examples of such expenditure would be expenditure that is in excess of: <ul style="list-style-type: none"> <li>- the market value of goods or services received; and</li> <li>- the reasonable expenditure to achieve intended.</li> </ul> </li> <li>• Capital in nature:</li> </ul>
4	<ul style="list-style-type: none"> <li>Monetary expenditure by employers towards skills development of qualifying employees</li> <li>• Expenditure under this category is most likely already deductible, regardless of BEE.</li> <li>• Where not already deductible, the taxpayer must prove that expenditure towards BEE was in the production of income.</li> <li>• Sections 12H and 12I are only allowed for approved projects.</li> </ul>	<ul style="list-style-type: none"> <li>- Recurring expenditure indicates a non-capital nature and expenditure with an enduring benefit indicates a capital nature.</li> <li>- Certain expenditure under the mining sector charter (and possibly under other sector charters) that affects BEE scorecards over multiple years is more likely to be capital in nature.</li> <li>- CGT implications and capital allowances (such as sections 11(e), 13sex or 15(a)), where expenditure is capital in nature, require consideration.</li> </ul>
5	<ul style="list-style-type: none"> <li>Non-monetary assistance by employers towards skills development of qualifying employees</li> <li>• Expenditure under this category is most likely already deductible, regardless of BEE.</li> <li>• Where not already deductible, the taxpayer must prove that expenditure towards BEE was in the production of income.</li> <li>• Quantify non-monetary assistance at fair value.</li> <li>• Sections 12H and 12I are only allowed for approved projects.</li> </ul>	<ul style="list-style-type: none"> <li>• Deductions for prepaid expenditure could be limited per section 23H (where expenditure affects the BEE scorecard for future years).</li> <li>• SARS binding rulings: <ul style="list-style-type: none"> <li>- Taxpayers can apply for a ruling on whether their specific expenditure is deductible.</li> </ul> </li> <li>• Deductions should be quantified correctly, as the amount actually incurred.</li> </ul>
6	<ul style="list-style-type: none"> <li>BEE verification expenditure</li> <li>• Deductible if any benefit can be shown from any expenditure towards BEE.</li> <li>• Consulting expenditure related to direct empowerment measures is not necessarily deductible.</li> </ul>	<p>Apportionment is possible where, for example, only a portion of expenditure was incurred in the production of income.</p>



In addition to section 11(a), special income tax deductions were identified that could be applicable in certain circumstances. Sections 12H, 12I and 18A can be utilised, but only for certain types of expenditure and only in qualifying circumstances. Capital allowances, such as sections 11(e), 13sex or 15(a), can be claimed in cases where expenditure is capital in nature. Based on the conclusion drawn from whether expenditure under each broad category can be deducted per section 11(a) and whether any special income tax deductions are available, best practice guidelines were then formulated.

In summary, even though expenditure towards indirect BEE measures has been found to be deductible in most cases, there are exceptions of which taxpayers should be aware. The proposed best practice guidelines include guidance that should ideally be considered before incurring expenditure towards indirect BEE measures. Further research is suggested to examine the full extent of CGT implications and the available capital allowances, where expenditure towards BEE measures is capital in nature.

## REFERENCES

- Acker T (2012). The deductibility of indirect empowerment measures relating to black economic empowerment in terms of the income tax act. Magister taxation thesis (unpublished). Stellenbosch University.
- Arya B, Bassi B (2011). Corporate social responsibility and broad-based black economic empowerment legislation in South Africa: Codes of Good Practice. *Bus. Soc.* 50(4):674-695.
- BEE Partner (2008). South African BEE tax: Application of BEE to taxation. [Online]. <http://beepartner.com/2008/09/19/south-african-bee-tax-application-of-bee-to-taxation> (Accessed: 24 May 2011).
- Bowman Gilfillan (2005). Black economic empowerment guide. [Online]. <http://services.bowman.co.za/Brochures/BEE/eBook/index.html> (Accessed: 1 December 2011).
- Brincker TE (2010). Taxation principles of interest and other financial transactions. Johannesburg: Butterworths.
- CIR v Pick 'n Pay Wholesalers (Pty) Ltd [1987], 49 SATC 132.
- De Klerk SS (2008). A critical analyses of broad-based black economic empowerment in the mining sector. Unpublished master's thesis. University of Johannesburg. [Online]. <https://ujdigispace.uj.ac.za/bitstream/handle/10210/3477/DE%20KLERK%20.pdf?sequence=1> (Accessed: 25 April 2012).
- Empowerdex (2007a). The Codes of Good Practice. [Online]. <http://www.empowerdex.co.za/Portals/5/docs/EmpowerdexGuide/Introductory.pdf> (Accessed: 1 January 2012).
- Empowerdex (2007b). The Codes of Good Practice: Scorecard essentials. [Online]. <http://www.empowerdex.co.za/Portals/5/docs/EmpowerdexGuide/Framework.pdf> (Accessed: 14 January 2012).
- Empowerdex (2007c). The Codes of Good Practice for qualifying small enterprises. [Online]. <http://www.empowerdex.co.za/Portals/5/docs/QSECodeGuide/QSE%20Guide%20-%20Intro.pdf> (Accessed: 1 November 2011).
- Empowerdex. (2009). The Generic Scorecard. [Online]. <http://www.empowerdex.co.za/BEELEGISLATION/TheGenericScorecard/tabid/206/Default.aspx> (Accessed: 14 January 2012).
- Ernst & Young (2006). The deductibility of consulting fees in today's corporate environment. [Online]. [http://www.saica.co.za/integritax/2006/1427\\_The\\_deductibility\\_of\\_consulting\\_fees\\_in\\_today\\_s\\_corporate\\_environment.htm](http://www.saica.co.za/integritax/2006/1427_The_deductibility_of_consulting_fees_in_today_s_corporate_environment.htm) (Accessed: 2 February 2011).
- Ernst & Young (2011). Corporate social responsibility expenditure. [Online]. [http://www.saica.co.za/integritax/2011/1916.%C2%A0Corporate\\_social\\_responsibility\\_expenditure.htm](http://www.saica.co.za/integritax/2011/1916.%C2%A0Corporate_social_responsibility_expenditure.htm) (Accessed: 21 February 2012).
- Ferreira P, De Villiers C (2011). The association between South African listed companies' BEE scores and market performance. *Meditari Account. Res.* 19(1): 22-38.
- IQUAD & KPMG (2010). The evolution of BEE measurement – 2010 BEE survey. [Online]. <http://www.kpmg.com/ZA/en/IssuesAndInsights/ArticlesPublications/Advisory-Publications/Documents/KPMG%20and%20IQUAD%202010%20BEE%20Survey-The%20Evolution%20of%20BEE%20Measurement.pdf> (Accessed: 21 January 2012).
- Jack V, Harris K (2007). Broad based BEE: The complete guide. Johannesburg: Frontrunner Publishing.
- Jones S (2009). When can you deduct an expense? Section 11(a) contains the general principles. *Tax Breaks Newsletter* 277:2-4.
- Kotze D (2012). BEE and tax. [Online]. <http://www.moneyweb.co.za/mw/view/mw/en/page295168?oid=573448&sn=2009+Detail> (Accessed: 6 June 2012).
- KPMG (2004). Tax treatment of expenses attendant upon empowerment charters: How far-reaching is the precedent set in Warner Lambert v C: SARS? [Online]. [http://www.saica.co.za/integritax/2004/1245\\_The\\_tax\\_treatment\\_of\\_expenses\\_attendant\\_up\\_on\\_empowerment\\_charters.htm](http://www.saica.co.za/integritax/2004/1245_The_tax_treatment_of_expenses_attendant_up_on_empowerment_charters.htm) (Accessed: 2 February 2011).
- Matten D, Moon J (2008). Implicit and explicit CSR: A conceptual framework for a comparative understanding of corporate social responsibility. *Acad. Manage. Rev.* 33(2):404-424.
- Mohamed G, Roberts S (2008). Weak links in the BEE chain? Procurement, skills and employment equity in the metals and engineering industries. *J. Contemp. Afr. Stud.* 26(1):27-50.
- Ngcobo S (2011). DTI'S relook at BEE: A comment. [Online]. <http://www.moneyweb.co.za/mw/view/mw/en/page292679?oid=536159&sn=2009+Detail> (Accessed: 24 May 2011).
- Ntombela V (2006). Scoring social responsibility points – any deductions on the cards? [Online]. <http://www.accountancysa.org.za/resources/PrintItemArticle.asp?ArticleId=961&Issue=640&LoadFrame=N> (Accessed: 2 February 2011).
- PwC (2009a). Corporate social responsibility expenditure – SARS issues a binding class ruling. [Online]. <http://www.pwc.com/za/en/assets/pdf/pwc-synopsis-may09.pdf> (Accessed: 25 June 2010).
- PwC (2009b). Corporate social responsibility expenditure. [Online]. [http://www.saica.co.za/integritax/2009/1765\\_Corporate\\_social\\_responsibility\\_expenditure.htm](http://www.saica.co.za/integritax/2009/1765_Corporate_social_responsibility_expenditure.htm) (Accessed: 13 September 2010).
- PwC (2010). Income tax guide 2010–2011. Durban: LexisNexis.
- South African Revenue Service (SARS) (2009). Binding Class Ruling BCR 002: Expenditure incurred on corporate social investment programmes. [Online]. <http://www.sars.gov.za/Tools/Documents/DocumentDownload.asp?FileID=46880> (Accessed: 17 February 2011).
- South Africa (2007). Codes of Good Practice on Black Economic Empowerment. *Government Gazette*, 500(29617):3-96. [Online]. <http://bee.thedti.gov.za/34.htm> (Accessed: 21 March 2012).
- South Africa (2008). Framework for accreditation and verification by all verification agencies. *Government Gazette*, 776(31255):3–80. [Online]. <http://bee.thedti.gov.za/docs/1-15.pdf> (Accessed: 12 March 2012).
- South Africa. Department of Trade and Industry (2005). Tourism BEE Charter and Scorecard: A user's guide. [Online]. <http://www.info.gov.za/otherdocs/2005/bee/bee4.pdf> (Accessed: 17 January 2012).
- South Africa. Department of Trade and Industry (2006). Construction Sector Broad-Based Black Economic Empowerment Charter. [Online]. [http://www.publicworks.gov.za/PDFs/documents/Charters/Construction\\_Charter\\_Version\\_6-Final%20-26-01-06.pdf](http://www.publicworks.gov.za/PDFs/documents/Charters/Construction_Charter_Version_6-Final%20-26-01-06.pdf) (Accessed: 10 January 2012).
- South Africa. Department of Trade and Industry (2007). Background to, intention and application of the Codes of Good Practice. [Online]. [http://www.thedti.gov.za/economic\\_empowerment/docs/Inside.pdf](http://www.thedti.gov.za/economic_empowerment/docs/Inside.pdf) (Accessed: 1 May 2011).
- South Africa. Department of Trade and Industry (2011). BBBEE Amendment Bill published for comment. [Online]. <http://www.sabinetlaw.co.za/economic-affairs/articles/bbbee-amendment-bill-published-comment> (Accessed: 1 April 2012).
- Standard Bank (2008). BBBEE explained: An easy guide to

- understanding broad-based black economic empowerment. [Online]. [http://www.standardbank.co.za/standing/Standard%20Bank/StandardBank/static%20files/Business/StdBank\\_BEE\\_Guide.pdf](http://www.standardbank.co.za/standing/Standard%20Bank/StandardBank/static%20files/Business/StdBank_BEE_Guide.pdf) (Accessed: 2 February 2011).
- Steyn L (2011). New BEE threat for tenderpreneurs. [Online]. <http://mg.co.za/article/2011-12-09-new-bee-threat-for-tenderpreneurs> (Accessed: 25 April 2012).
- Tarrant G (2007). Are BEE costs tax deductible? *Bus. Brief* 11(6):18.
- Thersby K (2006). The tax deductibility of BEE costs. *Tax Breaks Newsletter* 249:5-6.
- Tucker C (2003). Summary of black economic empowerment in South Africa. [Online]. <http://www.bowman.co.za/LawArticles/Law-Article~id--783041820.asp> (Accessed: 22 January 2012).
- Van Schalkwyk L (2010). General deductions. In: Stiglingh M, Koekemoer A, Van Schalkwyk L, Wilcocks JS, De Swardt R, Jordaan K (eds.) *SILKE: South African income tax*. Durban: LexisNexis.
- Wilcocks J (2010a). Special deductions and assessed losses. In: Stiglingh M, Koekemoer A, Van Schalkwyk L, Wilcocks JS, De Swardt R, Jordaan K (eds.) *SILKE: South African income tax*. Durban: LexisNexis.
- Wilcocks J (2010b). Capital allowances and recoupments. In: Stiglingh M, Koekemoer A, Van Schalkwyk L, Wilcocks JS, De Swardt R, Jordaan K (eds.) *SILKE: South African income tax*. Durban: LexisNexis.
- Williams RC (2009). *Income tax in South Africa: Cases & materials*. 3rd edition. Durban: LexisNexis.
- Woolley R (2005). *Everyone's guide to black economic empowerment and how to implement it*. Cape Town: Zebra Press.
- Warner Lambert SA (Pty) Ltd v Commissioner for SARS [2003], 65 SATC 346.