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The deductibility of BBBEE expenditure – Binding Class Ruling 72

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by Kyle Fyfe, Senior Associate
reviewed by Ernest Mazansky, Head of Tax Practice

SARS has recently issued Binding Class Ruling 72 ("**BCR 72**"), in which it ruled on the tax deductibility of contributions by a group of employer companies to fund an employees' ownership trust to enable the trust to participate as a part shareholder of a newly established black-owned and controlled property entity. It appears from the ruling that the taxpayer accepted that the transaction had a dual purpose – to obtain a favourable broad-based black economic empowerment ("**BBBEE**") status, and to incentivise employees.

The ruling is novel as SARS has ruled that 50% of the employer contribution by each group company is not tax deductible because it is of a capital nature. Taxpayers who claim that expenditure incurred in order to improve their BBBEE scorecards would seek to rely on the decision in *Warner Lambert SA (Pty) Ltd v C:SARS* 2003 (5) SA 344 (SCA), and may disagree with SARS's view.

In the *Warner Lambert* case, the taxpayer was required to incur social responsibility expenditure, as the subsidiary of an American parent company, in order to avoid sanctions in the United States of America, in terms of the Sullivan Code. SARS argued that the expenditure was of a capital nature and not tax deductible. However, the Supreme Court of Appeal disagreed, and held that the social responsibility expenditure was incurred in order to protect the taxpayer's income earning structure and was therefore deductible.

SARS has previously granted rulings that acknowledge the deductibility of social responsibility expenditure incurred in order to improve a taxpayer's BBBEE scorecard, such as Binding Class Ruling 2. In principle, there is no difference between the types of expenditure that are incurred in order to improve a taxpayer's BBBEE scorecard. However, one factor that may have been taken into account by SARS is that the expenditure is incurred on a one-off basis, and may provide an enduring benefit to the group companies, especially bearing in mind that the contribution received was used to subscribe for shares in the holding company of each employer company.

This line of argument must be carefully considered, as the so called enduring benefit test is meant to apply where the expenditure creates or preserves a capital asset in the hands of the taxpayer. In the circumstances in BCR 72, there is no asset that is created or preserved (this was a decisive consideration for the revenue/capital test in *BP Southern Africa (Pty) Ltd v C:SARS* 2007 BIP 364 (SCA)). In our view, contrary to BCR 72, there is an argument to be made that the full contribution should be deductible. Therefore, in conclusion the deductibility of BBBEE expenditure remains uncertain, and should be carefully considered on a case-by-case basis.

It should be borne in mind that binding rulings of all types (a) are binding on SARS only and not on the taxpayer, even in relation to the taxpayer to which the ruling has been given, and (b) neither SARS nor a taxpayer can cite any published ruling in any proceedings between them.

Kyle Fyfe

Director

View Profile

Ernest Mazansky

Director, Werksmans Tax (Proprietary) Limited

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