An evaluation of the possibility to abuse the PBO tax exemptions by religious organisations in South Africa.

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Mini-dissertation accepted in partial fulfilment of the requirements for the degree Master of Commerce in Taxation at the North-West University

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Graduation: July 2022

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DECLARATION

I, Thandi Felicity Kunene, declare that this mini-dissertation named: ***"An evaluation of the possibility to abuse the PBO tax exemptions by religious organisations in South Africa"*** is my own work; that all sources used or quoted have been indicated and acknowledged by means of complete references, and that this mini-dissertation was not previously submitted by me or any other person for degree purposes at this or any other university.

Thandi Felicity Kunene

2022/06/09

Date

DEDICATIONS

I dedicate this dissertation to my late mother Malitaba “Mapaseka” Victoria Kunene (*nee* Moipatli), who was brave until the end in the battle against breast cancer. I was never ready, but I hope that I have made you proud thus far. I love you for eternity.

ACKNOWLEDGEMENTS

To my family and friends, thank you for always believing in me. Your support and encouragement gave me the courage to continue. Phindile and Sipho Kunene, you remain my pillars of strength and I love you both dearly.

To my supervisor, Dr Karina Coetzee, it has not been an easy journey and I often-times found myself wondering if I should continue. Thank you for your kind words of encouragement and always assisting me when I needed you.

I thank God for seeing me through to the end. The journey was long and difficult at many a times, but He gave me strength to persevere through it all.

“I can do all things through Christ, who strengthens me” Philippians 4:13.

ABSTRACT

South Africa has seen an increase of prophets who have who have commercialised the gospel of Christ for power and monetary gains and those who have resorted to risky healing practices such as snake-eating, petrol-drinking and spraying congregants with insecticides, placing the lives of congregants, desperate for a miracle, in danger.

These rising incidents of abuse of human rights by religious organisations as reported by the media in recent years, as well as the inquiry and findings of the Commission for the Promotion and Protection of the Rights of Cultural, Religious and Linguistic Communities have shone the spotlight on possible abuse of the public benefit organisations' tax exemption status by religious organisations in South Africa.

Following the investigation into the "commercialisation of religion and abuse of people's belief systems", there is an interest to look into the tax compliance of religious organisations. The purpose of the research was to evaluate the possibility to abuse the tax exemption provisions of Section 10(1)(cN) read with Section 30(1) of the Income Tax Act (58 of 1962) by religious organisations, churches in particular, evading the payment of taxes under the guise of being public benefit organisations carrying out a public benefit activity.

To assist with the research, a literature review was done. The documentary study comprised of South African legislation, legislation of other jurisdictions as well as other writings. It included a detailed content analysis of the prior literature on the rationale behind the tax exemption status granted to public benefit organisations with specific emphasis on churches.

It was found that there is cause for concern regarding the extensive non-compliance in the public benefit organisation sector in general, and religious organisations to be specific, especially the charismatic churches. Religious organisations have failed to comply with the requirements for continued tax exemption, and evidence points to the abuse and misuse of the tax exemption provisions of Section 10(1)(cN) read with Section 30 of the Income Tax Act (58 of 1962).

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LIST OF ABBREVIATIONS AND ACRONYMS

BMR	Bureau of Market Research
CRL	Commission for the Promotion and Protection of the Rights of Cultural, Religious and Linguistic Communities
CAF	Charities Aid Foundation
CGP	Code of Good Practice
CSO	Civil Society Organisation
DSD	Department of Social Development
ICNL	International Centre for Not-for-Profit Law
IoDSA	Institute of Directors in Southern Africa
IRS	Internal Revenue Service
IRC	Internal Revenue Code
NDA	National Development Agency
NDP	National Development Plan
NGO	Non-governmental Organisation
NPC	Non-profit Company
NPO	Non-profit Organisation
P.A.Y.E	Pay As You Earn
PBA	Public Benefit Activity
PBO	Public Benefit Organisation
PWC	PricewaterhouseCoopers
SACRRF	South African Charter of Religious Rights and Freedoms
SAIBA	Southern African Institute for Business Accountants
SARS	South African Revenue Service
USA	United States of America

KEY WORDS

Abuse, commercialisation, fraud, inurement, philanthropy, public benefit activity, public benefit organisation, reasonable remuneration, religion, tax exemption, tithe, unrelated business income.

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CHAPTER 1: INTRODUCTION AND BACKGROUND

1.1. South African religious organisations in perspective

The cultural tradition of Ubuntu, an African concept rooted in the principle of caring for one another, is a motivating factor for philanthropy amongst citizens and organisations in South Africa (ICNL, 2017:2) and this concept, as an expression of African humanism, is the basis on which moral decisions on gifting have been made and institutionally embedded (Fowler & Mati, 2019:730).

South Africa is a religiously active country, with a variety of established religions as well as indigenous belief systems (Habib & Maharaj, 2008:27). A study conducted by Everatt and Solanki (2005:18) found that religion plays an important role in influencing social giving. Different religions emphasise that giving is connected to a profound sense of duty and devotion to the realisation of spiritual salvation. For instance, there is a regular payment or contribution known as *zakaat* among Muslims, *tzedalah* among the Jews, *dana* among the Hindus, and tithe payments among Christians, which is required of those devoted to these faiths (Habib & Maharaj, 2008:27).

Smith and Jennings (2016:8) state that South Africans, in aggregate, donate billions towards philanthropy to recipients such as religious organisations, schools, charities, and others. A survey conducted by Charities Aid Foundation South Africa (hereafter CAF South Africa) (CAF South Africa, 2019:7), found that 80 percent of the participants had undertaken philanthropic activity, in the form of giving money to a church, or other religious organisations, non-profit organisation (hereafter NPO), or other charity, and that time given to a church, or other religious organisations was found to be the number one cause for volunteering, followed by helping the poor and supporting children.

It was furthermore found that cash donations were the most common method of giving, making up 73 percent of the total donations made in 2018. On this basis, it becomes evident that South Africans contribute a lot of money towards religious organisations, more especially the church (CAF South Africa, 2019:10).

Forster (2019) notes that in South African society, religious leaders benefit from higher levels of public trust than the government and the private sector, unlike in many other western modern democracies. In recent times, there has been an increase in the reports of flamboyant religious leaders offering healing and prosperity through miracles, using unorthodox and questionable methods. Pastors have been displaying lavish lifestyles of prosperity in testimony that obedience and sacrificial giving is the road to wealth, thus

convincing members of their organisations to part with their money (Gbotoe, 2013:74; Masenya & Masenya, 2018: 636; Van der Watt, 2012:45).

The media reported that the leaders of some religious organisations were instructing their congregants to eat foreign substances such as grass and snakes while some made their congregants drink petrol (ENCA, 2014; News24, 2015a; Pondani, 2019:4,31). In other instances, people were convinced to part with considerable sums of money in exchange for a “guaranteed” miracle or blessings (Makhubu, 2016; Mokoena, 2015). These events have left a large portion of society questioning whether religion has become a commercial institution or commodity, used for the benefit of the selected few. In response to this state-of-affairs in the religious sector, the Commission for the Promotion and Protection of the Rights of Cultural, Religious and Linguistic Communities (hereafter CRL Rights Commission) undertook an investigative study focusing on the commercialisation of and the abuse of human rights by the religious institutions in South Africa (CRL Rights Commission, 2017:6).

The mushrooming of scores of churches and religious organisations throughout the country in recent years has irrevocably changed the face of religious communities (CRL Rights Commission, 2017:9). The media (ENCA, 2016a) has reported on a pastor of a prominent church charging women R5 000 for a prayer to secure marriage while there are also reported instances where people have had to pay a fee ranging from R1 000 up to R25 000 for gala dinners, and in other instances congregants were charged up to R5 000 for a one-on-one session with the leader of the church (Kgatle, 2019:6; Magadla, 2017; Mashaba, 2015).

Dlamini (2018) reported that pastors held a wealth creation conference targeting those who seek wealth available through God’s grace and whose hearts were ready to receive miraculous power to create such wealth in order to finance the kingdom of God. This conference came at a cost of R3 500 per person for a general ticket and R5 500 per person for a VIP ticket. There has been a trend in churches and religious groups where items such as anointing oil, holy water, handkerchiefs, and many other “anointed” goods are marketed to congregants, claiming that the buying and use of these products will attract God's blessings, favour, and protection as well as answers to their prayers (Abraham, 2015; Kabatebate, 2019).

The rise of these church activities that prioritise wealth and prosperity has posed questions and concerns about the appropriateness of using church ministry and

theological education as resources for economic survival. The African continent has seen a surge in many wealthy pastors and prophets who have amassed personal wealth by preaching the gospel of material prosperity (Gbotoe 2013:70). There has been a shift in the church ministry that went from the conventional and parsimonious clergy who preached heaven to the world, to materialistic and flamboyant clergy termed "*gospelpreneurs"*, who seem to have turned the gospel into a profitable commodity (Magezi & Banda, 2017: 1).

The above clearly paints a picture that supports the view that there is commercialisation of the gospel by churches, and an undertaking of commercial activities which are clearly distinct from tithes and offerings. The media reports on the abuse of human rights by religious organisations, as well as the findings of the CRL Rights Commission (2017), have shone the spotlight on the activities of religious organisations in South Africa and their status as tax exempt organisations (Makhubu, 2016; Mokoena, 2015; News24, 2018a).

The CRL Rights Commission is a Chapter 9 institution designated by the South African Constitution (hereafter SA Constitution) (1996:92) to strengthen constitutional democracy in South Africa. Although it is a constitutional arm of the state, it operates outside government and other state organs' interference and is free of partisan politics, subject only to the Constitution (Banda, 2019:1; CRL Rights Commission, 2017:7). The objectives of the CRL Rights Commission include promoting respect for the rights of the cultural, religious, and linguistic communities and promoting tolerance and unity amongst these communities based on equality, non-discrimination and freedom of association (SA Constitution, 1996:94).

Pursuant to its constitutional mandate, the CRL Rights Commission conducted a series of investigative hearings on the commercialisation of religion and abuse of people's belief systems in South Africa (Banda, 2019:2). The final report released by the CRL Rights Commission in July 2017, sparked interest into the abuse of the tax exemption provisions by religious organisations, who evade the payment of taxes under the guise of being public benefit organisations (hereafter PBO), carrying out public benefit activities (hereafter PBA) (CRL Rights Commission, 2017:6).

The SA Constitution (1996) guarantees religious freedom to all, and as part of the duty of the state to create a positive and safe environment for citizens to exercise their religious freedom, the government allows for a favourable benefit tax regime to NPOs,

which religious organisations form part of, exempting these from the payment of normal tax. However, there are requirements to be met by these organisations in order to enjoy and benefit from this tax exemption status as stipulated in Section 10(1)(cN) read with Section 30 of the Income Tax Act (58 of 1962). Being exempt from normal taxation is not automatic and for the South African Revenue Service Commissioner (hereafter SARS Commissioner) to approve the application of any PBO for this tax exempt status, the organisation must be carrying on one or more PBAs as its sole or principal objective and must comply with conditions and requirements as set out in Section 30 of the Income Tax Act (58 of 1962).

Further to this, the activities and resources of the PBO must be expended for the furtherance of this objective, and the sole or principal objective must equate to the activities it physically and actively conducts (SARS, 2017:5). The qualification criteria for PBOs to qualify for the exemption from normal tax as set out in Section 30 of the Income Tax Act (58 of 1962) is that the activities are conducted in a non-profit manner driven by altruistic or philanthropic intentions, and the benefit of these activities must be made accessible to the public at large. Such organisations are prohibited to use activities conducted to either directly or indirectly enhance the economic self-interest of any connected person to the organisation, save for the reasonable remuneration in exchange of services rendered. An organisation whose intent is to make a profit will not qualify for approval, however, an organisation which conducts a trading activity may qualify, if it meets the set requirements (SARS, 2017:5)

The controversial media reports about pastors have society questioning whether religion has become a commercial vehicle for the enrichment of a few (CRL Rights Commission, 2017:4). The recent increase in the establishment of such churches in South Africa has changed the landscape of religion (Dube , Nkoane & Hlalele, 2017:331; van Wyk, 2019b). It has thus become vital to evaluate the tax exemption provisions availed to religious organisations by Section 10(1)(cN) of the Income Tax Act (58 of 1962), which provides preferential tax treatment for NPOs, exempting certain receipts and accruals of approved PBOs from payment of normal tax.

Due to financial constraints that churches have faced which are similar to those faced by non-profits, churches have had to adopt measures targeted at increasing their economic sustainability (Kitawi, 2015:1026). As a result, the church should take proactive steps to optimise its activities and assure long-term sustainability and service continuity (Kitawi, 2015:1025-1026).

Seide (2013, cited by Rockson, 2019:2) indicates that while churches are not businesses, they operate in the same ways that businesses do in terms of marketing, finances, operations, sales, advertising, and human resources. Churches boast multiple revenue streams mostly linked to commercial businesses that are far removed from the principal activity of advancing religion (Kitawi, 2016:1026; Ukah, 2003:150-161). As with other NPOs, the tax exemptions are extended to the religious sector**.**

While acknowledging the role that PBOs, including religious organisations, play in assisting the government to discharge its obligation, and their contributions to the moral regeneration of the society, one cannot turn a blind eye to some cases of human rights abuses and misuse of the tax exemption provisions, which lead to the erosion of the tax base; hence the need to evaluate compliance to the current legislation.

1.2. Problem statement

The rationale for the tax exemption is to enable PBOs to continue with activities that benefit the public, in aiding the government, without the financial burden of paying taxes. Considering the commercial activities undertaken by religious organisations, and churches specifically, which are not related to the core purpose for granting the tax exemption, this is an issue worth looking into.

The problem is the possible misuse of tax exemptions by religious organisations.

1.3. Research objectives

In order to answer the research problem, the following objectives were formulated:

1.3.1. Primary objective

The primary objective for this research is to evaluate the possibility to abuse the PBO tax exemption provisions of Section 10(1)(cN) and Section 30 of the Income Tax Act (58 of 1962) in relation to religious organisations.

Considering the controversy around the practices of some religious organisations, the evaluation of the religious tax exemptions and the understanding of its administration in other countries could aid South Africa in finding possible remedies to these practices.

1.3.2. Secondary objectives

In order to achieve the primary objective, the following secondary objectives have been formulated:

- Discuss the concept and history of tithes, in order to understand the concept and the rationale behind the exemption from tax for religious organisations (Chapter 2).
- Outline the legislative and governance framework for the PBOs particularly the taxation legislation and the governance structures of the sector, with special focus on religious organisations. An overview of the compliance status of the religious organisations in South Africa will be discussed (Chapter 3).
- Conduct a comparative analysis of the PBO tax exemption for religious organisations between South Africa and the United States of America (hereafter USA) (Chapter 4).
- Discuss the possible misuse/abuse of the PBO tax exemption and the lack of governance and accountability in religious organisations in South Africa. (Chapter 5).
- Develop recommendations and conclude on possible remedies for the misuse and abuse of the PBO tax exemption provisions by religious organisations. (Chapter 6).

1.4. Research design and methodology

Kothari (1990:1) states that research work in common language, refers to a knowledge quest, a scientific and systematic search for relevant information on a given topic. Research methodology is a way to systematically solve the research problem, understood as a science of studying how scientific research is conducted and describes the basis for applying specific measures for the classification, selection, and scrutiny of data and its application to respond to the research problem. In it, the different steps a researcher usually takes in the study of the research problem along with the logic behind it are studied. The researcher needs to know not only the methods / techniques of the research but also the methodology (Creswell, 2014:2; Durrheim, 2006:34; Kothari 1990:8; Leedy & Ormrod, 2016:3; MacMillan & Schumacher, 2001:166).

Research design and methodology make use of either qualitative or quantitative methods, or a combination of both methods, to analyse data (Creswell, 2014:5). Quantitative research generally specifies the numerical assignment to the phenomena being studied, while qualitative research produces narrative or textual descriptions of the phenomena under study (VanderStoep & Johnston, 2009:7).

This study followed a qualitative research method using a literature review to achieve the research objectives. Through the literature review, the focus was on underlying concepts, principles, and rules relating to the taxation of NPOs with a sharp focus on religious organisations, especially churches.

1.4.1. Research paradigms

Social inquiry can be approached in a variety of ways, and researchers will have to choose from a variety of methodologies. They must comprehend the theoretical and philosophical ideas on which the research is based, even if they are making a decision based on practical considerations (Holloway & Wheeler, 1996:21). A researcher's ability to comprehend and express beliefs about the nature of reality, what can be understood about it, and how we go about getting this knowledge is required as elements of research paradigms (Rehman & Alharthi, 2016:51).

Bryman (2012:630) defines a paradigm as “a cluster of beliefs and dictates which for scientists in a particular discipline influence what should be studied, how research should be done, and how results should be interpreted”, while Nieuwenhuis (2012:48) indicates that it functions as a lens or organising principles for interpreting reality. It is an elementary belief system and theoretical framework that includes assumptions about *ontology* (nature of reality and existence), *epistemology* (theory of knowledge and what constitutes valid knowledge) *methodology* (researcher’s principles and ideas on which their procedures and strategies are based) and *methods*, a manner of comprehending and studying the world's reality (Holloway & Wheeler, 1996:21; Rehman & Alharthi, 2016:51). A paradigm tackles fundamental assumptions such as ontology (belief in the nature of reality), epistemology (the link between knower and knowing), and methodology assumptions (Nieuwenhuis, 2012:47- 48).

Researchers make assumptions (sometimes implicitly) about the nature of reality, how it exists, and what can be understood about it (ontology). A researcher's inquiry into what form of reality exists is prompted by the ontological question. Following an explicit or implicit ontological belief system leads to specific epistemological assumptions (the nature of knowledge and the process of acquiring and validating it) (Rehman & Alharthi, 2016:51- 52). What we think about the world but can't prove and our actions in the world, including those we take as researchers, cannot happen unless those paradigms are referenced (Nieuwenhuis, 2012:48; Du Plooy-Cilliers, Davis & Bezuidenhout, 2014:19).

Du Plooy-Cilliers *et al.* (2014:20) and Rehman and Alharthi (2016:51) indicate that there are three dominant approaches to research, namely - positivist, interpretivist and critical realist. Positivism is a natural science approach founded on the belief that only empirical, measurable facts can provide legitimate information. Positivists believe in a single, objective, and stable external social and physical existence controlled by laws (Du Plooy-Cilliers *et al.,* 2014:24-25).

Interpretivism rests on the belief that there is a fundamental difference between people and things and as a result, the two cannot be studied in the same way because human beings are forever changing, with the environment influencing that change (Du Plooy-Cilliers *et al.,* 2014:24-25, 27). Interpretivists reject the concept of objective knowledge and reality, preferring to view facts as fluid. They claim that reality is a social construct based on the meanings people assign to their own perceptions and relationships with others. Interpretivist theory, unlike positivist science, tells a narrative (Du Plooy-Cilliers *et al.,* 2014:29).

The researcher's worldview (ontology) is largely reflected in the paradigm he or she chooses and how s/he believes knowledge is created (epistemology) (McKerchar, 2008:6). The researcher in this study followed the ontological position of interpretivism primarily because taxation is a social phenomenon, and secondarily, because the tax exemption for PBOs is already established research and literature. Furthermore, qualitative research, which is related to the interpretivism paradigm is used in this research study.

1.4.2. Qualitative research

According to Holloway and Wheeler (1996:5) the aim of qualitative research as a research methodology, is understanding the processes, social and cultural contexts underlining different behavioural patterns. This type of research methodology primarily deals with the “why” issues in research. Emphasis is placed on the quality and depth of information and not on the extent or scope of the information provided, as is done in quantitative research (Nieuwenhuis, 2012:51).

Qualitative research involves the collection of multiple forms of data rather than relying on a single data source. The researchers then analyse all the data, make sense of them, and organise them into codes and themes that cover all the data sources (Creswell & Creswell, 2018:257).

1.4.3. Literature review

VanderStoep and Johnston (2009:10) explain that a literature review serves two purposes. Firstly, to convince the reader that the researcher knows the literature and is competent to conduct investigations. Secondly, the reader should be convinced that the study proposed fits into the existing knowledge base and should explain how the study proposed is needed to fill a gap in the literature. Creswell and Creswell (2018:62) support the notion that the analysis of the literature helps to decide if the subject is worth investigating, and if it offers insight into ways the researcher can narrow the scope to a specific area of investigation.

The literature review includes a detailed content analysis of the prior literature on the tax exemption status granted to NPOs with specific emphasis on churches and religious organisations. It includes the concept and history of tithes, the tax exemption status of the church, as well as the analysis of the possibility to abuse the tax exemption provisions in legislature.

To assist with the research, the method used is a review and a critical analysis of the literature documenting the reform of the Income Tax laws governing NPOs. This is done by studying a range of sources, including the South African taxation and NPO legislation, submissions to parliament, and reports by Commissions of inquiries, as well as the USA tax legislation and other materials.

1.5. Significance of the study

This research is important because it introduces a debate where academics and the tax authority can discuss the misuse of the tax exemption by religious organisations in South Africa and propose possible solutions thereto.

1.6. Limitations of the research

This research focuses on the income tax exemption provisions available to PBOs with a particular focus on religious organisations with a further focus on Christian charismatic churches. It does not deal in detail with other organisations performing a PBA as mentioned in the Ninth Schedule to the Income Tax Act (58 of 1962). The research also does not consider other taxes that are to the benefit of the NPO sector. Although the research does discuss religious organisations at large, the portion thereof as it relates to tithes is limited to the Christian religion. It was a challenge to obtain accurate statistics relating to the number of churches/religious organisations operating in South Africa, as

well establishing the percentage of these organisations undertaking commercial activities.

Additionally, financial statements and/or annual reports of religious organisations are not readily available and accessible in the public domain. This presented a challenge as those that could be found, were old.

As this research is a mini dissertation, these limitations are considered reasonable.

1.7. Chapter classification

Chapter 1: Introduction of the study

This chapter introduces the study, the problem statement, research objectives, and the significance of the study, and explains the research method adopted in the study. Limitations to the research are also included.

Chapter 2: Overview of the history of tithing

An overview of the history and concept of tithes is provided, followed by a discussion on tithing in the English church. This is to gain understanding on the tradition of giving, both from the religious (biblical) as well as common law perspective. A brief discussion on the obligation by Christians to pay tithes and the rationale behind the religious tax exemption follows thereafter.

Chapter 3: Legislative framework of PBOs in South Africa

In this chapter, there is a discussion on the development of the NPO sector and the legislative framework governing PBOs, focusing on the tax legislation as well as an overview on the corporate governance framework and compliance status of the sector in South Africa, of which religious organisations are a part.

Chapter 4: Literature review: A comparative analysis of the tax exemption for religious organisations in South Africa and the United States of America.

The literature review of articles published by other scholars and researchers as well as other published material to address the problem statement, and the primary and secondary objectives are in this chapter. A comparison of the tax exemption criteria as set out in Section 10(1)(cN) read with Section 30 of the Income Tax Act (58 of 1962) is done against Section 501(c)(3) of the Internal Revenue Code of 1986.

Chapter 5: Discussion of possible misuse of the tax exemption in South Africa and lack of governance and accountability in religious organisations.

The possible misuse of the tax exemption provisions of Section 10(1)(cN) and Section 30 of the Income Tax Act (58 of 1962), as well as other non-compliance issues by the church is deliberated. The financial statements of a few churches are reviewed in order to assess if there is disclosure on unrelated business income derived from commercial activities. The limitation was that few were readily available and/or accessible in the public domain and those that the researcher could obtain were from older financial year-ends.

Chapter 6: Conclusion and recommendations

A summary of the findings of the research conducted is given, with specific focus and consideration on whether the research objectives have been met in order to address the problem statement in Chapter 1.

Recommendations on possible remedies for the misuse and abuse of the PBO tax exemption provisions by religious organisations is given, as well as suggestions for further research possibilities.

CHAPTER 2: OVERVIEW OF THE HISTORY OF TITHING

2.1. Introduction

This chapter contains a discussion on the history of tithes as well as the religious tax exemption as per the secondary objective in Chapter 1, section 1.3.2. The aim of the discussion is to review the tithing practice, purpose, and history in order to gain understanding of the rationale behind the religious tax exemption.

Under Mosaic Law, tithes consisted of one tenth of the yearly produce from the land or labour, taken as a tax for sustenance of the church and the clergy (Brace, 1998:15; Easterby, 1888:1). According to Kelly (2007:5-8) there are four definitions of tithing, which are:

1. A tithe that is ten percent of income given willingly or through a legal obligation to a religious organisation for the support of the clergy and those in need.
2. A tithe that is associated with voluntary giving where the congregants are encouraged to give from their finances in accordance with their means based on net income and there is neither coercion nor legal obligation of giving a tenth from one's gross income.
3. A tithe as ten percent tithe of gross income which is seen as an indisputable biblical obligation from which the poor are not exempted.
4. The Mosaic Law tithe given for the benefit of the Israelites, to the tribe of Levi in lieu of their loss of land in Israel which was their inheritance and for their ministry.

Brace (1998:15) asserts that although the payment of tithes had been an established and universal tax, it has been under dispute and its legitimacy has never been established beyond all doubt. She goes further to explain that tithes were an indiscriminate tax, which was levied on everyone, irrespective of religious allegiance, but only provided for the maintenance of the clergy and those accommodating themselves to an all-inclusive established church in England. Even those who had an objection to religion and did not attend church, were still obliged to pay for the services of their local minister (Brace, 1998:17).

The dispute into the payment of tithes is still present, centuries later. While some churches teach the practice of tithing a tenth of one's income as being compulsory, some view it as not being imperative for Christians to tithe although they emphasise that

it is good practice and a blessing to give for the needs of the church. There are also some churches that reject this as being a remnant of the Old Testament practice which is irrelevant in today's society (Budiselić, 2014:144; Swanson, 2007:162).

As the tax exemption of religious institutions is the focus of this study, and tithes are central to the revenue received by the church, it is therefore important to understand tithes and their history.

2.2. The concept and history of tithes

Mosaic Law provided that all tithes were devoted to the whole tribe of Levi, barring the one-hundredth part of the tithes which was distributed to the priests, in return for administering the benefits of religion (Clarke,1894:2). Constable (1964:12) states that there were three types of tithes within the system; the first one for the Levites, the second reserved for the sacrificial offering, and the third given every third year for charitable purposes to orphans, widows, and strangers. The main categories of tithes constituted the following:

- predial tithes - were those from the products of crop farming or the natural increase of livestock.
- personal tithes - were the profits on commodities of man's labour.
- mixed tithes - were from products which combined nature and labour - such as milk, cheese and wool (Constable, 1964:12).

2.2.1. The commencement of tithing

Clarke (1894:2) notes that the practice of paying tithes has been in existence from the earliest of times preceding the introduction of Christianity. While the Jews devoted the tithes to the tribe of Levi at Jerusalem, the Greeks and Romans paid a tenth of their war spoils to Apollo and Hercules respectively. Payment of tithes was also a common practice in the early African kingdoms, supported by evidence found in Egypt (Clarke, 1894:2; Easterby, 1888:2; Lansdell, 1906:2-3).

Samson (2002:21) supports this view and contends that tithing as referred to in the Bible as a contribution to the temple, was both a tax and contribution as evidenced by history from the Egyptian, Mesopotamian, Chinese and the Inca[1] empires, all of which were theocratic - meaning that religion and government were intertwined. The King or Emperor was regarded as a god and paying tribute to this leader served as both a

[1] Ancient Peruvian empire

religious and governmental duty (Samson, 2002:21). The first instance on record of the payment of tithes in the Bible is found in Genesis 14:20-23, when Abraham, returning as a victor from the battle and having rescued Lot, gave to the priest-king Melchizedek, the “tithes of all” (Carlé, 1994:8; Clarke, 1894:1). Constable (1964:9) notes that the history of tithing in the Middle Ages commences in the Bible and the records of theologians and interpreters of scripture. Further noted by Constable (1964:9) is that the payment of tithes, unlike any other specific and regular charge during this era, was directly based on a spiritual principle. Croteau (2005:30) posits that tithing was so prevalent in ancient cultures such that its origins cannot be explained other than it was God’s command from the beginning.

2.2.2. The practice of tithing

Tithes were given as free will offerings to the clergy, who were satisfied with the voluntary nature thereof (Clarke, 1894:xviii). The custom of paying tithes as a moral obligation gradually became a compulsory and legally established obligation by the time of Edward the Elder of Wessex[2] and was also influenced by pressure exercised in the confessional box (Clarke, 1894:xix; Easterby, 1888:10). Constable (1964:24) confirms this and notes that historians have recorded that tithes were rarely paid, as they were but a pure moral obligation until they were made part of secular law in the eighth century and the non-payment thereof was punishable by a penalty or a fine (Clarke, 1894:xix; Easterby, 1888:12).

So contentious was the matter of tithing, that those who failed to make payment could also face imprisonment, seizure of possessions and even death (Easterby, 1888:61; Clarke 1894:xviii). Clarke (1894:xviii) rejected tithing as an unbiblical tax collected to support the ministers of the Church of England and asserted that anyone who supported these abhorrent methods of extortion was foolish.

2.2.3. Recipients of tithes

Constable (1964:10) and Brace (1998:16) state that the Bible does not explicitly specify to whom the tithes were to be paid and how they were to be disbursed but most references to the tithe in the Old Testament show that tithes were treated as God’s special property and a privilege of his ministers, or they are referred to as being paid to the tribe of Levi. Carlé (1994:8) supports the view that the Bible is not explicit on the

[2]Wessex was an Anglo-Saxon kingdom in the south of Great Britain (Angus 1938:194)

utilisation of the tithe and the frequency thereof and he further states that all we know is that Abraham only paid this tithe once-off after his victory.

The priests in Jerusalem did not receive the tithes but rather the first fruits and heave[3] offerings and one hundredth part of the tithes (tithe of tithes) devoted to the entire tribe of Levi (Clarke, 1894:2). Clarke (1894:2) notes that the Jews stopped the practice of paying tithes after the second temple was destroyed and they were dispersed. This was because the Jews believed Jerusalem to be the only place where tithes were to be paid and it also became impossible to trace the Levite tribes and the priesthood to whom the tithes would be paid (Clarke, 1894:2).

Following the Levitical custom, the Roman popes also started to demand the first fruits and the tithe of tithes (one hundredth part of the tithes) from the hierarchy and the appointed clergy under their spiritual jurisdiction in the early fourteenth century to finance crusades (Clarke, 1894:2). In England and the rest of the Christian world, the principle of tithing prevailed for centuries until the time when King Henry the Eighth assumed supreme authority over the English church and demanded that the first fruits and a tenth of the tithe be handed over to the monarchy (Clarke, 1894:2; Hanson, 2017a; Hanson, 2017b; Lansdell, 1906:iii). It was Queen Anne who, by an Act promulgated in 1704, gave the tithes back to the church for the special purpose of supplementing the poor (Brace, 1998:16-17; Clarke, 1894:xx & 2).

There is an assertion that the founding father of Christianity and his apostles did not impose instructions on the payment of tithes but rather stated that the ministers of the gospel were to be sustained on a voluntary basis (Clarke, 1894:xvii). Easterby (1888:2) is also of the same view in that for centuries, the Christian church relied solely on voluntary offerings which were also to be used for charity. Clarke (1894:21) remarks that the clergy did not have the sole right to use tithes and that it was the Fourth Lateran Council held in 1215 that gave them a common right to the church tithes (Clarke, 1894:xx & 21; Easterby,1888:2).

Clarke (1894:4) maintains that contrary to some beliefs, the scripture does not support the ministers living off the tithe because if that was the case, it would have been explicitly so stated.

[3] One-sixtieth of the gross produce

2.2.4. Purpose of tithing

Tithing was viewed by believers as a sacred duty to give a preordained portion of their wealth to God, as it is through God's providence that they were able to attain their worldly wealth and because their salvation depends on the faithful payment of tithes (Constable, 1964:13; Price & Rahdert, 1993:853). Watson (as quoted by Easterby, 1888:15) indicated that a tithe is a due to be paid by every believer, lest they want to risk their soul, and that the very act of payment of tithes was equated to an act of worshipping God.

The book of Deuteronomy introduces another system of tithing in addition to the annual tithe, which was to be used for a feast that occurs every three years for the benefit of the Levites and the needy people (Constable, 1964:10). Selden and Bromton (1618, cited in Clarke, 1894:46 & 49) were of the stance that charity was the primary basis of all ancient references to the payment of tithes in the Christian religion.

Stemming from the scriptures, as well as the theological and scholarly interpretations of these over the years, it can be argued that the original intent of the tithes and offerings were not to be used exclusively for the welfare of the priests and their officials but for the vulnerable in the communities such as the poor, widowed, and the orphaned.

2.3. Tithes in the church

Clarke (1894:xvii) found contradictory schools of thought when searching for the facts and truth on the origin of tithes in the Christian church generally, particularly the English church. One party held the view that the payment of tithes was a continuation of scriptural laws in the church and that Christians were bound to pay it whether they liked it or not. In order to support this stance of paying tithes, scriptures from the Old and New Testament were distorted and given false meanings and sham miracles paraded in their works. The other party, whose views were supported by John Selden, argued that neither patriarchal custom nor the Mosaic Law bound Christians to the payment of tithes. Selden argued that the founder of Christianity and his apostles did not leave any written instructions for the payment of tithes but rather, stated how ministers were to be maintained, being purely on a voluntary principle (Clarke, 1894:xvii & 7; Easterby, 1888:2).

The argument on the establishment of laws on tithes is supported by Ladurie and Goy (1982:14) who record that the tithing practice was established by biblical foundations as well as canon law over 2000 years ago and should have been levied on agricultural

products, livestock, and on the proceeds from fishing, hunting, and windmills as well as on the profits of trade and industry, but it rapidly became a traditional method the church used to collect the annual percentage of crops and livestock.

The types of tithes were categorised into the following classes, varying from region to region (Ladurie & Goy, 1982:2):

- major tithes based on agricultural production, wheat, barley, oats, rye, and wine.
- green tithes (also called lesser tithes) based on vegetables and fruits.
- blood tithes represented livestock.

Ladurie and Goy (1982:14-15) further argue that the tithe was a living institution and therefore subject to change as it was based on custom rather than rigid law. Tithes were levied on all land belonging to the common people, the nobility, or the Church, although other religious orders were exempt. The tithe represented a percentage of the harvest which ranged from 10 percent to 14 percent with the lowest being 2.5 percent, based on the locality and region. The level of resistance and hostility on the part of the peasants made the tithe subject to changes (Ladurie & Goy, 1982:14-15).

The church has a long history in Africa, having been introduced by missionaries with the goal of spreading the gospel while enlarging their countries' colonies (Kitawi, 2015:1027). The establishment of Christianity in South Africa came with the arrival of Dutch settlers in 1652. Public expression of Christianity was initially exclusively granted to the Dutch Reformed Church, and it was not until 1806 that this was extended to other denominations (Elphick, 1997:1; Harrison, 2004:11). The new brands of Christianity, including the Anglican and Presbyterian, which were established by the churches of England and Scotland, as well as the Methodist, Baptist and Congregational churches, were brought to South Africa by the British settlers in 1820. By the early 1800s, Christian missionaries came from England, Scotland, France, the United States, and the Netherlands. The fervent missionary activities were motivated by the need to establish European religious equivalents in South Africa (Harrison, 2004:12; Mosimann-Barbier, 2014:10-12). As a result, Christianity in South Africa was heavily influenced by the European missionaries who settled in South Africa and the customs of the English and Dutch churches, such as tithing, were adopted. It is this history that motivated the choice of some of the countries below while others were chosen to give a general background into the history of tithes.

2.3.1. England

Clarke (1894:xviii), notes that the custom for the giving of tithes as free-will offerings in England gradually began in the eighth century and the clergy were satisfied with such voluntary offerings. He also said that the number of people tithing gradually increased in the ninth to the eleventh centuries, resultant from the pressure exercised in the confessional box, until it became a customary and a legal requirement for all to pay tithe offerings (Clarke, 1894:xix). Clarke (1894:92) further notes that the councils that set up the laws and principles of the tithe payment to bishops and their clergy, were mainly made up of the clergy themselves.

2.3.2. France

The payment of tithes in France was first instructed by the laws of the provincial council near the end of the sixth century and was continuously enforced from the ninth to the end of the twelfth century. There is no evidence contradicting that the first confirmation of a civil decree for the payment of the tithes, was given by the King of France Charlemagne, (also known as Charles the Great) in a royal command (Clarke, 1894:xix, 43; Easterby, 1888:4, 10). This civil decree only enforced what was already the existing clerical law or prevailing custom of paying tithes. Through the royal command, he awarded the clergy the legal claim to tithes. There were compulsory statutes regulating the collection and accounting of tithes received and a record of those who did not pay. A jury sat witness to disputed claims and the continually disobedient were faced with a penalty and or being excluded from the church. Further non-payment led to one's house being shut and any attempt to enter it resulted in imprisonment (Clarke, 1894:33-34; Easterby, 1888:4).

2.3.3. Hungary

Ladurie & Goy (1982:18) state that tithing was introduced in Hungary when King Istvan decided to join Christian Europe and obligated his subjects to convert to Christianity. The properties of the pagans who resisted were confiscated and a large part donated to the Catholic Church and other religious orders. The duty to establish and control the tithe collection was usually entrusted to the lords of the manors by the clergy (Ladurie & Goy, 1982:18).

The church's role was not only to convert the people, but they were also obliged to care for the widows and orphans. It was in fact a law that a quarter of the income received from tithes was to be expended for helping the poor, and as a result, the monasteries

established and ran hospitals and took an active part in poverty relief programs (Kuti, 1996:13-14).

After the Turks' occupation of central Hungary in the middle of the sixteenth century, the tithe became a "royal tithe" in most regions, leased to the Royal Chamber as a state tax intended to cover the cost of defence (Ladurie & Goy, 1982:18; Mihalache, 2015:58). There was also the parallel obligation of a fine by those who had not paid the tithe, called the *nona*, which was due to King Stephen. In the fourteenth century, this fine was made a compulsory levy of 10 percent of the harvest, paid in kind, which gives an indication that the real tithe to be paid was less than 10 percent (Ladurie & Goy, 1982:19).

2.3.4. Spain and its colonies

In Spain, the tithe was levied on all agricultural products and livestock and applied to all farmers, and only the clergy and the native Indians were exempted from paying tithes, on condition that the priests were conducting farming themselves, and the condition for the native Indians was that the products had to be grown on their own or on communal land to be exempted. This was a similar practice in most parts of France. In certain regions, the tithe was divided into three parts with one third going to the bishop and his chapter, another third to the local clergy, and the final third divided between the king and the building fund committee (Ladurie & Goy, 1982:19-20).

2.3.5. Italy

In Italy, not much importance was placed on the tithe, and in most cases records could not separate tithes from the seigneurial dues, rents, or even taxes. In instances where it was independently accounted for, it was granted to or appropriated by non-ordained men as it was sometimes allowed to be a part of household tax or fall into disuse. It accounted for a small portion of the revenues of an already extremely rich Catholic church (Ladurie & Goy, 1982:20-21).

2.3.6. Germany and Poland

From the records preserved by the church, hospitals, and universities in Germany, it is recorded that the tithe was a major element in the revenue of the clergy, whereas in Poland, the tithe was paid first in kind, then in money, and it took the form of a subscription which was set at a fixed rate for a long period. The church was a landowning class which could be the reason why they were mainly tasked with the collection of and enjoyed the benefit of tithes (Ladurie & Goy, 1982:21, 25).

2.4. Obligation to pay tithes

Easterby (1888:2) contends that the New Testament does not contain any special instruction of the tithe system. Selden (1618 , cited in Easterby, 1888:3) states that there was no law either by the church council or by the Roman Pope, instructing the payment of tithes until the end of the eighth century where the imperial laws concerning the payment of tithes were laid instructing every person to give tithes, which were then distributed according to the order of the bishop. By the enactment of this Imperial Law, the charitable nature of the tithes in the Frank Kingdom[4] ceased and it assumed a legal character. It therefore became a tax imposed and enforced by the imperial authority and power, not a spontaneous prayerful offering of Christians (Easterby, 1888:2-3). Clarke supports this stance by arguing that for more than four hundred years after the introduction of Christianity, there was no authoritative law by the church for the payment of tithes. He questioned whether Christians are justified in adopting this law for the payment of tithes that, taking into account that the foundation for the payment of tithes was in the Mosaic Law, had no force outside the Jewish territory (Clarke, 1894:7).

According to Constable (1964:24), the payment of tithes was not legally enforceable, and Christians may have felt no duty to pay them as it was not compulsory. Clarke (1894:xviii-xx & 20) also notes that the payment of tithes gradually became a common right over time and by virtue of this, people became legally bound to pay tithes. Constable (1964:15) states categorically that irrespective of one's position in church, no one was exempted from the religious obligation to pay tithes as much as no one was exempted from prayer, charity, or the Ten Commandments. He argues that priests were also not exempted from the obligation to pay tithes.

Contemporary scholars have differing views on whether tithing is compulsory to Christians or a voluntary form of giving. Some argue that the tithe is still binding on believers with some citing it as a practice that believers should observe but which is not mandatory (Van der Merwe, 2010:2). Johnson (1984:22) argues that the tithe is not legalism when based on the spiritual interpretation of the Old Testament, while Richards (1985:308) argues that although the principle of tithing was laid down before the law as shown in the book of Genesis, there is no instruction to suggest that tithing should be

[4] Frank, member of a Germanic-speaking people who invaded the Western Roman Empire in the 5th century. https://www.britannica.com/topic/Frank-people

practiced by Christians. Achtemeier (1986:191) echoes this view by arguing that there is no duty laid upon Christians in the New Testament to pay tithes.

2.5. Background to the religious tax exemption

Salamon and Anheier (1997:5) agree with past research which has established that there is a close connection between religion and non-profit activity, with religious sentiments and influence playing a role to motivate voluntary activity and philanthropic giving. Kaldor (2003:6) and Douglas (1987:43) affirms that the Christian Church has, since the earliest of times, been predominantly involved in the provision of social services, rather than the government.

Cilliers and Retief (2002:61) state that the origins of the equivalent concept of a modern hospital as we have come to know it, is to be credited to the Christians. Thompson and Golden (1975:6) state that hospitals were established as health care facilities inside monasteries initially to care for the monks, and later for civilians. It was in this manner that the monasteries played a vital role in promoting health care and developing hospitals, which were later supported by Christian charity. The driving force behind hospitalisation in Europe steadily changed from being almost exclusively associated with monasteries to increased involvement by civil authorities, although church hospitals continued to expand, opening public hospitals (Cilliers & Retief, 2002:63).

The exemption of religious organisations from tax is said to be a practice ingrained and observed in many ancient cultures dating back to the priests of Egypt and can be also traced to biblical times as evidenced by *Genesis* 47:26 and *Ezra* 7:24 (Martin, 2017:313; Pfeffer, 1984:17). The preferential tax treatment enjoyed by charities is an ancient tradition based not only on the principles of the divine, but also of procedure. The tax collectors were of the view that the gods who owned religions were beyond the periphery of their authority (Westenberger, 2014:227). According to Pfeffer (1984:17) Christian churches enjoyed exemption from tax starting as early as the fourth century when Christianity was established as the Roman state church and accorded the privilege of exemption from paying tax on church buildings and the land used for church purposes. It then became the norm to exempt churches from taxes in most countries including England and its colonies. Martin (2017:313) however asserts that so old is the practice of religious tax exemption that most historians cannot pinpoint as to when exactly the tax exemption came into effect.

The Church in Europe was instrumental in the establishment of hospitals and schools and later went on to establish great universities under their total control. The same happened in the USA, where colleges were either founded by the church or by religious men (Cilliers & Retief, 2002:61 & 63; Powis Smith, 1924:47). In South Africa, state run schools were provided by the government for white people, while there was no provision made for the natives of the land. Religious organisations played a key role in providing education for black people from early this century up until 1953, with the Roman Catholic and the Anglican Church being the key players (Mazibuko, 2000:4).

King (1999:976-978) notes that it was the early settlers in America that “established” churches by force of law together with the practice to exempt churches from taxation. The English law had influence on the tax exemption for charities in the USA, a practice that continued uninterrupted after independence and the adoption of the First Amendment (Pfeffer, 1984:17).

The justification for the exemption was that society benefits from the activities of the charities, which are conducted not for personal gain but for the mutually supportive relationship between the state and these organisations (Lieber, 2004:175; Westenberger, 2014:228-229).

The above shows the extent to which the church was involved in charity and providing social services in communities in which they were established. It can be deduced, based on the evidence presented, that it was for these reasons that the church was extended tax exemption benefits, in order to enable the services provided to be executed without the burden of having to pay tax.

2.6. Conclusion

The purpose of this chapter was to outline the roots of the tithes and religious tax exemption in order to address the secondary objective in Chapter 1. This is important as it will assist in the chapters that follow to clarify why religious organisations are exempted from tax and evaluating whether this should continue.

It was illustrated in section 2.5 above, that the church played a key role in providing health care facilities, schools, and universities in Europe and the USA as well as providing other social services to aid the government, and it was for such reasons that their activities were exempted from taxation. A similar approach was implemented in South Africa, as indicated by Elphick (1997:1 & 3), who states that up until the 1950s, Christian churches and missions in South Africa founded schools and controlled most

schools for Africans, and sponsored social work, medicine, and nursing to varying extents. This is no longer the case, as the South African government is largely responsible for the provision of these services. However, the state also delegates some of these tasks to the NPO sector to be performed on behalf of the state (Choto, Iwu & Tengeh, 2020:591-592). The NPO sector receives financial funding from government through subsidies, grants, or contracts (DSD, 2001:6). To further support the sector, the government promulgated the National Development Agency Act (108 of 1998) which established the National Development Agency (hereafter NDA), whose primary objective is to provide grant funding to civil society organisations (hereafter CSO) to enable them to implement projects and programmes that meet developmental needs of poor communities and to strengthen their institutional capacities. Nhlapo (2012:159) found that there were few religious organisations that were involved in social programmes such as poverty alleviation as these were mainly carried out by non-governmental organisation (hereafter NGO). Based on this, there is therefore a need to evaluate the purpose for the continued granting of the tax exemption to religious organisations, given their operations and conduct, which calls for a determination of the extent of social services or PBAs they provide.

The next chapter will provide a discussion of the legislative framework governing PBOs, particularly those regulating the taxation and governance of religious organisations in South Africa, as well as an overview of their compliance state.

CHAPTER 3: LEGISLATIVE FRAMEWORK OF PUBLIC BENEFIT ORGANISATIONS IN SOUTH AFRICA

3.1. Introduction

Philanthropy has long been part of the fibre of South African society, this being inspired by the concept of Ubuntu amongst Africans. *Ubuntu* is a cultural tradition founded on the concept that "*Umuntu ngumuntu ngabantu*"[5]. This concept has inspired altruistic giving on both the individual and organisational levels in South Africa (ICNL, 2017:2; Kombo, 2002:231). According to the Charities Aid Foundation World Giving Index (hereafter CAF World Giving Index) of 2019, South Africa is ranked Number 12 for people who would likely help a stranger, and ranked Number 45 for overall giving, out the 143 countries surveyed. The Index comments that the results support the belief that *Ubuntu* is a strong motivation behind the charitable acts in Africa (CAF World Giving Index, 2019:15)

An NGO may be defined as a collective of citizens not coordinated by the government and institutionally separated from it, who form organisations that are characterised by a dependence on donations to run operations and operating with a non-profit distributing motive (Hofisi & Hofisi, 2013b:524; Mazibuko, 2000:1). These organisations mobilise themselves to meet certain needs in their communities which are not fulfilled by government, either due to lack of resources or such needs not being on the government's development priorities. In a functioning society, such needs ought to have been fulfilled by the government (DSD, 2001; Hofisi & Hofisi, 2013a:291; Mazibuko, 2000:1).

Religious organisations have been playing a major role in the field of philanthropy and providing social services and helping with the development of communities. This mandate is influenced by the commandments and chronicles found in many religious customs (Goodchild, 2016:7; Habib & Maharaj, 2008:79-80, also see previous chapter).

This chapter will provide a historical overview of NGO/NPOs and the developments in the tax legislation pertaining to PBOs, the governance structures under which they operate, as well as a discussion on the PBAs qualifying for tax exemption. This is in accordance with the secondary objective outlined in section 1.3.2 of Chapter 1. This historical theoretical exposition will provide insight into the role of the PBOs in South

[5] Loosely translated "a person is a person through people"

Africa and the preferential tax treatment available. Particular attention will be given to the religious sector.

The terms PBO, NPO, non-profit company (hereafter NPC) and NGOs possess similar characteristics as charity/voluntary sector vehicles and are often used interchangeably, hence for the purposes of this research it was prudent to treat them all as synonymous, except where the context required the use of a specific term.

3.2. The legislative framework of the NGO/PBO sector

According to Allwood (1992), the operations of NGOs in South Africa have largely been shaped by the political atmosphere which prevailed in the country prior to democracy. The politically hostile environment in the apartheid era led to most of these organisations operating under a veil of secrecy and this led to poor governance systems, lack of accountability, and resistance to sharing information with the government (Habib & Taylor, 1999:75; NDA, 2016:97-98,127). Having acknowledged the unforeseen effects of the sector staying unregulated, the state promulgated legislation aimed at regulating the sector (Habib & Taylor, 1999:77; NDA, 2016:2, 97-98).

The legal framework for civil society in South Africa is considered supportive of NGOs in general, and philanthropic giving in particular. Civil society in South Africa has had to reinvent itself and adjust to new realities of building the country into one coherent society and defeating the enemies of poverty, unemployment, and inequality in the new democratic dispensation (ICNL, 2017:1; NDA, 2016:1).

In South Africa, NPOs are governed and regulated under the Non-Profit Organisations Act No. 71 of 1997 (hereafter the NPO Act) whose aim is to (a) provide a conducive and supportive environment for non-profit organisations, and (b) to establish an administrative and regulatory structure allowing for non-profit organisations to conduct their activities.

Although registration under the NPO Act (71 of 1997) is voluntary, registration is a prerequisite for obtaining funding from the state, which serves not only as a regulator for NPOs, but as a key donor as well (ICNL, 2017:1). This implementation of the NPO Act (71 of 1997) was followed by an objective tax exemption system for PBOs which was made possible by the amendments to the Income Tax Act in 2001. This tax regime aimed to promote local philanthropy and improve the financial sustainability of PBOs by allowing them access to a number of tax benefits (ICNL, 2017:1; NDA, 2016:128).

The current legislation requires all natural and corporate residents of South Africa to include all receipts and accruals of a revenue nature in their calculation of gross income, in accordance with Section 1 definition of gross income found in the Income Tax Act (58 of 1962). However, Section 10(1)(cN) of the Income Tax Act (58 of 1962) exempts from normal tax any receipts by and accruals to a public benefit organisation duly approved by the SARS Commissioner in terms of Section 30(3).

3.2.1 Overview of the tax framework for the NGO/PBO sector pre- 2000

Prior to the 1980s, the political and legal system was only supportive of NGOs directed to serving the white community and the racial order facilitated by the policies of apartheid (Habib & Taylor, 1999:74). The relationship between the NGOs opposed to apartheid and the state during the 1980s was antagonistic and the administrative and legal sphere was unfavourable for the NGO sector (Habib & Taylor, 1999:75; Weideman, 2015:2). The hostile environment during the apartheid era and the laws that were put in place to thwart fundraising efforts including the unfavourable tax laws limited the development of the sector and led most of these organisations to operate covertly, receiving funding through illicit channels (Habib & Taylor, 1999:74-75). The consequence of this *modus operandi* was that some of the organisations had poor governance mechanisms, lacked accountability, and strategic planning as well as being opposed to sharing information with the authorities. While this was effective under the oppressive apartheid government, it presented challenges in the post-apartheid state (Hofisi & Hofisi, 2013b:523; NDA, 2016:97-98).

The sector has had to reinvent and reposition itself to the new realities in the democratic dispensation and align itself to the new goal of rebuilding South Africa for the benefit of all its citizens, as co-drivers of development within the new democratic structure and the associated civil freedoms (NDA, 2016:98; Weideman, 2015:2). The sector experienced challenges after 1994 and declined as donor-funding was reduced (Nelson, 2000). Funds were being redirected to the new democratic government and skilled and experienced personnel joined the state and this impacted on the effectiveness and impact of the sector (Habib & Taylor, 1999:76; Weideman, 2015:2). Although the sector gradually recovered in the latter part of the 1990s, it remained smaller, less effective, and more fragmented than it had been in the 1980s (Weideman, 2015:3).

As a result of these challenges, as well as the economic climate in the mid to late 1990s, many tax exempted non-profit organisations were compelled to seek alternative sources

of funding and started looking into generating income through the supply of products and services (Katz Commission, 1999:8). This development presented fiscal challenges including that these tax exempt organisations would be competing with the tax-paying entities in the market as well as the erosion of the tax base. There was also an opportunity created for the abuse of the tax exemption, particularly by hybrid organisations which sought to combine profit-making (taxable) and philanthropic (non-taxable) activities (Katz Commission, 1999:8).

Prior to the 2001 amendments, the principal tax exempting provisions for tax exemptions were found in Section 10(1)(f) and Section 10(1)(fA) of the Income Tax Act (58 of 1962) and were limited to religious, charitable, and educational activities that had a public character, as well as any fund whose sole object was to provide funds for any religious, charitable, or educational institution. Nelson (2004:194) notes that although the ambit of these sections was broad, there were challenges in that the SARS Commissioner applied a restrictive, narrow, and inconsistent interpretation to these statutes. Another challenge was that there were no clear set objectives for approval, and tax exemption status was granted on a case-by-case basis, relying heavily on the discretion of the SARS Commissioner, and there was negligible litigation challenging the SARS Commissioner's judicial interpretation and implementation of these legislative provisions (Brewis, 2006:5; Katz Commission, 1999:3, 5; Nelson, 2004:193-195).

The campaigns by the non-profit sector lobbying for a more enabling tax environment in South Africa were driven by the strong belief that tax incentives play a critical role in charitable giving and that the tax laws in place were not encouraging the financial sustainability of the sector (Nelson, 2004:193). As a result of the growing lobbying, the Katz Commission (1999) was appointed to review the fiscal legislative framework governing the NPO sector and to advise on possible changes to create a more economically supportive environment. The Katz Commission recognised that there was unanimous support for the importance and justification for the privileged tax status that the NPO sector enjoys, both locally and internationally, and expressed the view that there was a necessity to develop clear and flexible formulations that had reference to the objective criteria, thus eliminating the need to rely upon arbitrary or subjective discretions of the SARS Commissioner (Katz Commission, 1999:1, 2, 5 & 7).

The Katz Commission (1999:1) was tasked with reviewing the conservative provisions of Section 10(1)(f) and Section (10)(1)(fA) of the Income Tax Act (58 of 1962) and advising on possible changes to create a more economically supportive environment for

NPOs. Of concern then, was the medieval application of the legislative language with terminology that did not reflect a contemporary understanding of the prevailing status of development, altruism, or public benefit. Based on this legislation, the SARS Commissioner would consider the following, in categorising an organisation and therefore its tax status:

a) “The organisation's purpose.
b) The actual operations of the organisation.
c) Regular religious services conducted, entailing a system of faith, a creed and form of worship.
d) A regular congregation, the members of which contribute by way of voluntary gifts.
e) A complete organisation of ordained ministers.
f) A distinct and definite ecclesiastical government.
g) Public character - the organisation must be managed and controlled by a body of members who hold their position by virtue of election. There must be no autonomous control by certain members. The whole beneficial interest, including administration and control must vest in the members who are the public” (Katz Commission, 1999:5).

The other challenge was that there were conditions placed on organisations which included restrictions on where to invest funds; the distribution of the net revenue; and where it could be distributed or applied; and moreover, that the organisations could not carry on any business activities whatsoever (Nelson, 2004:194-195).

The Katz Commission (1999) suggested that the ideal legislation should provide clear objective criteria that could be applied in a standardised manner, referring to jurisdictional facts and thereby removing concerns about subjectivity, inconsistency, and perceived discrimination, and proposed a simple system where legislative provisions were self-regulating and designed in such a way that it would not need extensive audits from SARS. A recommendation was made that all NPOs be grouped under one umbrella of PBOs and be regulated by one section under the Income Tax Act (58 of 1962) (Katz Commission, 1999:7). This would be so that it did not place undue demands on the already limited resources that the SARS Commissioner had available (Heeger, 2010:29; Katz Commission, 1999:1-7; Nelson, 2004:202).

3.2.2 Overview of the tax framework for the NGO/PBO sector post- 2001

It was only in 2001 that the tax system for non-profit organisations underwent a complete overhaul and saw the introduction of the concept *"public benefit organisation"* and *"public benefit"* into the South African tax legislation. A list of eligible PBAs was approved by the Minister, and the provisions of the tax legislation became more detailed and comprehensive than was the case previously, the result of which was improved consistency and certainty. The promulgation of the amended provisions of the Income Tax Act (58 of 1962) also introduced specific sanction measures to deal with the misuse of the exempt status and tax non-compliance by a PBO (Steenkamp, 2014:676).

The general exempting provisions of Section 10(1)(cN) of the Income Tax Act (58 of 1962) promulgated in 2006, intended to benefit PBOs by regulating them more systematically and by extending the ambit of the tax benefits available to the sector. Section 30 was introduced to regulate the granting of tax exemptions by the SARS Commissioner by defining organisations that would meet the requirements of a PBO (Nelson, 2004:202). The introduction of these sections saw the simultaneous introduction of the Ninth Schedule to the Income Tax Act (58 of 1962), which expands on the activities that are defined as a PBA. Part 1 sets out a list of PBAs that, if executed, would entitle a PBO to receive preferential tax benefits. Part 2 entitles an organisation carrying out the PBAs that appear in both Part 1 and 2, to a "donor deductibility status", which enables the donors to the organisation to deduct the donations made from their taxable income. The new provisions provided that if an organisation qualified as a PBO, it could apply to the SARS Commissioner to be exempted from paying tax. This was contrary to the previous legislation of Section 10(1)(f) of the Income Tax Act (58 of 1962), which gave the SARS Commissioner complete powers to determine if an organisation qualified for the tax exempt status based solely on the discretion of the SARS Commissioner.

In accordance with this Section 30(3) of the Income Tax Act (58 of 1962), a PBO would have to meet the following requirements in order to be approved for a tax exempt status:

a) Comply with conditions as prescribed by the Minister;
b) submit the organisation's constitution, will or other written founding document, which requires that the PBO must:
    - appoint three unconnected persons to hold the fiduciary responsibility;

- prohibit the distribution of funds to any persons and to distribute funds solely to be used for the object for which it was formed;
- invest surplus funds only in prescribed instruments;
- transfer assets of the organisation to any similar PBO upon dissolution;
- not engage in any business undertaking or trading activities except within the limitations set in Section 30(3)(b)(iv) of the Income Tax Act (58 of 1962;
- not accept any revocable or conditional donations; and
- submit any changes to the founding documents to the SARS Commissioner.

c) not be party to any tax avoidance schemes, knowledgeably or not;
d) not pay excessive salaries save for what is considered reasonable in the sector;
e) comply with reporting standards determined;
f) take reasonable steps to ensure that funds provided to another PBO are utilised for the public benefit purpose;
g) must be registered under the NPO Act (71 of 1997); and
h) not utilise its resources for the advancement of or opposition to any political party.

3.2.3 Overview of the tax framework for the NPO sector post- 2006

The major development post- 2006 after the amendment of Section 10(1)(cN) of the Income Tax Act (58 of 1962), was the fact that if a tax exempt organisation was to engage in trading or business activities it could only attract income tax as a consequence, instead of possibly losing its tax exempt status, thus allowing for a partial taxation system for PBOs. Income derived from non-trading activities of an approved PBO is fully exempt from income tax, whilst income derived from trading or business activities is only exempt from tax to the extent that it meets requirements set out below (Income Tax Act 58 of 1962; SARS, 2018b:3 & 8):

- is integral and directly related to the PBO's sole or principal objective;
- the undertaking is conducted such that substantially the whole of it is to recover costs and does not present an unfair competitive advantage over taxable entities;
- is of an occasional nature, undertaken on a voluntary basis without compensation;
- from activities approved by the Minister of Finance where the benevolent nature and the connection to the sole or main objective, the profitability ratios as well

as if the exemption status could distort the economic status of the organisation, is considered;

The tax exemption on the receipts and accruals from business activities is limited to the greater of 5 percent of the total income and accruals of the organisation or R200 000 (called the basic exemption which will be discussed in Chapter 4).

3.3. Corporate governance framework for NPOs

Morrell (2009:539) states that there is no general or uniform definition for corporate governance. The institute of directors South Africa (hereafter IoDSA) (2016:11) defines corporate governance as the exercise of ethical and effective leadership by the governing body towards the achievement of the ethical culture, good performance, effective control, and legitimacy governance outcomes for purposes of King IV Corporate Governance for South Africa 2016 (hereafter King IV). The development of the King IV report was partially necessitated by the observation that NPOs had challenges with interpreting and adapting King III to their unique environment (IoDSA, 2016:1). The King IV report is a reiteration of the previous King III and sets out the philosophy, principles, practices, and outcomes of good corporate governance in South Africa (IoDSA, 2016:20). The PricewaterhouseCoopers (hereafter PwC) (2016) website states that good corporate governance requires understanding that no entity functions in a vacuum, but it is an integral part of society and thus accountable to current and potential stakeholders. Wyngaard (2017:2) states that corporate governance in the NGO sector is defined as “involving the board using its authority to steer the organisation towards its destination (vision)”.

Good corporate governance impacts on the success of an NPO in that it augments the functioning of the leadership structures and provides the arrangements by which the NPO should be controlled by the governing body in order to achieve its strategic objectives. The benefits that an NPO could derive from good governance are (IoDSA, 2016:87):

- added credibility and enhanced reputation.
- increased impact of activities and advocacy through stronger stakeholder relationships and more effective operational processes.
- access to funding, grants, and loans on better terms.
- the ability to leverage a wider pool of expertise for employment and volunteer work.

- better fraud prevention due to improved controls.
- business continuity arrangements that permit the NPO to operate under conditions of volatility, and to withstand and recover from acute shocks.
- leadership continuity through succession planning.

The principles of good corporate governance support ethical and effective leadership as valuable in all types of organisations. The King IV report was drafted in such a manner that the practices can be adapted taking into consideration the size, available resources, intricacy, and complexity of each organisation in order that the principles are applied, and good corporate governance is accomplished. Although the King IV report is not a legislative requirement, it is considered best practice for all entities to meet the standards it sets. Another innovation was including sector supplements, including the NPO sector, in the King IV report (IoDSA, 2016:3-7).

3.4. Legislative and regulatory framework for religious organisations in South Africa

The Income Tax Act (58 of 1962) defines a PBO as a non-profit company as defined in the Companies Act 71 of 2008, a trust or an association and whose principal objective is to carry out a PBA accessible to the public at large. Section 30 of the Income Tax Act (58 of 1962) states that such activities in themselves should be for non-profit, with philanthropic and altruistic intent, and not intended whatsoever to promote any one person's economic self-interest, except for what is considered reasonable remuneration to a fiduciary or employee of the organisation. Similar conditions are contained in the NPO Act (71 of 1997).

The Ninth Schedule to the Income Tax Act (58 of 1962) lists activities conducted by religious organisations primarily concerned with the advancement or practise of religion and whose activities encompass acts of worship, witness, teaching, and community service based on a belief in a deity, through the promotion and/or practise of a belief, and/or the promotion of, or engaging in, philosophical activities as a PBA. Churches fall under the wider umbrella of NPOs as part of religious organisations and will be recognised as such in this research. Under South African law, permission, registration, or certification is not required for a religious organisation to congregate, organise, and worship (Badenhorst, 2018; Thompson, 2019). This is a freedom that is protected by the SA Constitution and formulated in the South African Charter of Religious Rights and Freedoms (hereafter SACRRF) (2016).

There is very little to no paperwork and minimum administrative requirements involved in starting a church in South Africa. The process of starting a church is relatively easy and one can start a church anywhere using a backyard, living room, or any large space without any hassle as the SA Constitution guarantees the right to formation and exercise of religion (Badenhorst, 2018; Thompson, 2019).

Thompson (2019) explains that to open a bank account and benefit from the tax exemption regime available to churches, raise funds, sell merchandise, and solemnise marriages, the church must first register with an authority such as Department of Social Development (hereafter DSD) and SARS and be compliant with legislation governing the establishment, registration, and taxation of CSOs (Badenhorst, 2018; Wyngaard, 2010). Because most religious formations operate as NPC or NPO there is a requirement to register in order to be recognised as a legal entity. The type of legal identity within which a religious organisation chooses to arrange itself and whether it chooses to operate as an NPO or PBO may place a requirement to be registered with different departments or agencies of the state. The legal identity not only allows for the aforesaid, but also ensures that the lifespan of the organisation supersedes that of the original founder (Badenhorst, 2018).

As indicated in section 3.2 above, registration with the DSD is voluntary and free of charge in terms of the NPO Act (71 of 1997). To be eligible, the organisation must be a trust, company, or other association of persons established for a public purpose, and not be an organ of state. Qualifying organisations will be recorded into the register and issued with a certificate of registration by the Director of Non-profit Organisations at the DSD, which is valid until the registration is cancelled, the organisation is voluntarily deregistered, or wound up or dissolved. To retain the registration status, the organisation must keep accounting records and draw up financial statements within six months after the end of the financial year (NPO Act 71 of 1997). The NPO Act (71 of 1997) stipulates those financial records must be kept and drawn in accordance with the standards of generally accepted accounting practice (GAAP). A narrative and financial report as well as the accounting officer's report must be submitted to the Directorate within nine months after the end of the financial year.

The registration requirements for a NPO are found in Schedule 1 to the Companies Act (71 of 2008). Paragraph 1(3) of this Schedule stipulates that the profits and assets of a non-profit organisation are neither distributable nor transferable to an incorporator, a member, director, or any connected parties of the company. Profits and assets must be

applied to advance the non-profit motive for which the organisation was created as set out in the Memorandum of Incorporation. The exceptions that can be made regarding the distribution of income is *inter alia,* as reasonable remuneration for goods delivered, services rendered, or at the direction of the company. This requirement is presently also found in Section 30(3) of the Income Tax Act (58 of 1962), which lists all requirements to be met by public benefit organisations wishing to register as such with SARS as well as in the NPO Act (71 of 1997).

3.4.1. Legal identity of religious organisations in South Africa

Common law principles, influenced by both English and Dutch laws, and statutory laws, as well as indigenous laws to a certain extent, make up the South African law system. In addition, the South African constitutional dispensation led to the establishment of common law aligned with the SA Constitution and invalided those statutory laws that were found to be inconsistent with the new SA Constitution. In South Africa, laws dealing with civil society including the establishment, registration, and taxation of CSOs. are implemented mostly at the state level (Wyngaard, 2010).

South African law allows for religious organisations to be formed in any of three ways (Badenhorst, 2018; Wyngaard, 2010):

a) **A voluntary association in terms of the common law.**

   This requires that three or more people enter into an agreement with a common goal, other than the making of profit, such as establishing a church. The voluntary association is neither barred from receiving nor making money, however this may not to be the driving goal for the formation of the association (Bamford, 1982:117). The agreement (normally a constitution of the association) between the parties will determine the powers of the association, within the ambit of common law principles.

b) **A living trust.**

   The Trust Property Control Act, 1988 makes it obligatory that all trusts be registered with the Master of the Supreme Court. A trust deed is drawn up by the founder of the trust, where trustees are appointed. Trusts have stringent governance measures in place to ensure that trustees act in line with the letters of authority and compels them to focus on the public benefit goals stated on the trust deed.

c) A non-profit company (NPC)

NPCs must be registered with the Companies and Intellectual Properties Commission (CIPC) in terms of the Companies Act (71 of 2008). A Memorandum of Incorporation (MOI) stating the public benefit objective and setting out the rules of the company must be submitted to CIPC, *inter alia* other requirements. Members and directors of the NPC are barred from benefiting from the income or surplus of the company, although there is no restriction on the company making a profit. Any retained profits by the NPC must be retained in the company and used in pursuit of its main object or invested for the same purpose. Non-compliance to the Companies Act (71 of 2008) may result in criminal sanctions and personal liability claims.

Any of the above legal entities can voluntarily register as an NPO with the DSD in terms of the Non-Profit Organisation Act, 71 of 1997. Some organisations opt for registration as NPOs, as donor and funding agencies require registration as a prerequisite for funding, and association with a government agency does lend credibility to an organisation (Badenhorst, 2018; Wyngaard, 2010).

3.4.2. Tax regulations for PBOs

As alluded to previously, a PBO must first apply and be approved by the SARS Commissioner in order to access the tax exemption benefits granted to PBOs. An organisation must be constituted as a non-profit company, a trust, or an association of persons founded in South Africa, or be a branch of a foreign tax exempt organisation, for the SARS Commissioner to consider approving it as a PBO. Organisations whose formation is for altruistic and/or philanthropic purposes for the benefit of the public can be registered as PBOs and be exempt from the payment of tax on certain income in terms of Section 10(1)(cN) of the Income Tax Act (58 of 1962), subject to the requirements of Section 30 being fulfilled. The practice or promotion of religion, belief, and philosophical activities are part of the PBAs listed in the Ninth Schedule, Part 1 to the Income Tax Act (58 of 1962).

The current tax legislation clusters all NPOs under the legislation of PBOs and all are regulated by Section 10(1)(cN) read with Section 30 of the Income Tax Act (58 of 1962) without making any distinction between the types of NPOs and their characteristics. Should a PBO meet the requirements as set out in Section 30, it can apply to the SARS Commissioner for approval of the tax exempt status under Section 10(1)(cN) of the

Income Tax Act (58 of 1962). SARS requires a PBO to keep records for five years from the date the return is submitted in terms of Section 29(3) of the Tax Administration Act (28 of 2011). The fact that a PBO is approved as a tax exempt entity does not negate the obligation to file returns and retain records. This enables the SARS Commissioner to make a determination if the PBO is still operating within the prescripts of the approval and if partial taxation is applicable (SARS, 2018b:14, 15).

Organisations that rely on donors or funding agencies usually register with the DSD as a PBO, as registration lends credibility to the organisation which tends to boost donor confidence and fundraising efforts, as discussed in section 3.4.1 (Badenhorst, 2018). The state also requires NPOs to register with the DSD for any advancement of grants. A tax deduction for donations is available to taxpayers who donate to NPOs approved by SARS for pursuing the approved listed PBA. The tax deduction is limited and conditional on the possession of a Section 18A receipt issued by the organisation. This is to encourage taxpayers to continue being generous. The deduction of donations made in the form of tithes and offerings to a religious organisation is not tax allowable in terms of Section 18A of the Income Tax Act (58 of 1962).

Churches are primarily funded by tithes and are not reliant on donors or state grants (Tanui, Omare & Bitange *et al.,* 2016:41). Tithes and offerings to a religious organisation do not attract any donations tax irrespective of the registration status of the organisation, and there is no deduction from income tax for donations made towards religious organisations (SARS Guide, 2017:29). The fact that registration with the DSD is not a pre-requisite to operations and that donations tax is not levied on tithes paid to churches has the potential unintended consequence of creating a fertile ground for unscrupulous religious organisations to emerge and operate unregulated. Although there is rife non-compliance in the NPO sector, research shows there is high levels of compliance where there is an expectation of donor accountability, as there is pressure to demonstrate impact and failure of which would result in the withdrawal of funds (Burger, Jegers, Seabe, Owens & Vanroose, 2018:14).

3.4.3. Public benefit activities (PBA)

The objective of the National Development Plan (hereafter NDP) 2030 is to eradicate poverty and alleviate inequality by 2030. This can only be achieved by having all citizens involved, augmenting the state's capacity, and forging partnerships throughout society.

It is a long-term plan defining the targets of the state and the sectors that will play a role in achieving the objectives (NDP, 2012:1).

The SA Constitution (1996) places a burden on the state to ensure there are reasonable measures in place to progressively make certain rights contained in the Bill of Rights available and accessible. While the state has an important role to play in the development of the country, civil society and NGOs also play pivotal roles in supporting the government using their capacity to assist with societal and development needs where government has failed or is incapable (Hofisi & Hofisi, 2013a:291; Mazibuko, 2000:2; NDA, 2016:98; NDP, 2012:37; Ngandu & Motala, 2019:15). These organisations are also strategic in carrying citizens' concerns to the government, tracking implementation of policies and programmes and in some instances playing a regulatory role, contributing to attaining greater transparency and accountability in government (Ngandu & Motala, 2019:11; Sanders, 2010:49-50). The state recognises the role fulfilled by civil society in the promotion of development and community cohesion as well as in delivering essential social and employment programmes, easing the burden on the state, and has made available a preferential tax treatment which is aimed to support these organisations to supplement their financial capital and provide an enabling environment for them to achieve their aims (Brewis, 2006:4; Katz Commission, 1999:2 & 4; NDP, 2012:37; The Davis Tax Committee, 2018:1).

Any organisation that is carrying out a PBA and wants to qualify for tax exemption must ensure that such activities are conducted in a non-profit manner, with the intent of pursuing an altruistic or philanthropic purpose and for the benefit of the society at large. Although the operations should be non-profit, these organisations are not barred from undertaking a business or trading provided its sole or principal object remains the pursuing of a PBA. Receipts and accruals derived from a business or trading activity are exempted from income tax on condition that they fall within one of the four exemption categories included in Section 10(1)(cN) of the Income Tax Act (58 of 1962), discussed in Chapter 4, section 4.3.3. The PBAs are listed in the Ninth Schedule to the Income Tax Act (58 of 1962) as the following:

1. **Welfare and humanitarian**

Welfare and humanitarian activities are usually aimed at relieving suffering for families and people who need help as well as vulnerable members of the society. The right to social security and appropriate social assistance in instances where they are unable to

support themselves and their dependants is one of the rights guaranteed by the SA Constitution (1996:11). The expansion of social welfare services and the review of the funding of non-profit organisations in order to achieve the goals of the comprehensive social security forms part of the NDP 2030 (NDP, 2012:53).

2. Health care

The Bill of Rights (SA Constitution, 1996:11) gives everyone the right to have access to public health care services and prohibits the denial of medical treatment to anyone. The state is required to implement legislative provisions and other measures within available resources in order to achieve this. Therefore, the provision of holistic health care services to the destitute and disadvantaged is part of the mandate of the South African government.

3. Land and housing

Section 26 of the SA Constitution (1996) places the onus on the state to ensure that everyone has access to adequate housing and to protect citizens from arbitrary evictions. The current housing policy in based on a fundamental understanding that housing is a basic need as it impacts on human dignity, security, health, well-being, and access to livelihoods (Huchzermeyer, 2001:305). Lombard and van Wyk (2001:30) state that NGOs have a significant task to fulfil in augmenting and building capacity at community level, as well as facilitating and promoting the housing development process in South Africa. The NGO's close proximity to communities gives them a comparative advantage over the state and makes them strategically suitable to train and educate communities on housing developments (Lombard & van Wyk, 2001:30).

4. Education and development

Section 29 of the SA Constitution (1996) guarantees the right to access and receive education, including adult education, in ones' own language of choice, or in one of the 11 official languages. One of the objectives of the NDP 2030 (NDP, 2012:34) is to increase the quality of education by making preschool education accessible to all children and establishing literacy of children from Grade 3. Sanders, Phillips and Vanreusel (2012:791) state that NGOs play a very delicate role in education in that although education is a priority area for the government, there is a need to fill the gap where government fails to meet its objectives, and this is where civil society would step in to fill in the gap.

5. Religion, belief, or philosophy

One of the freedoms entrenched in the SA Constitution is the right to freedom of religion (Coertzen, 2014:128; SA Constitution, 1996:7). It is the guarantee of a democratic society and provides every South African with the liberty to exercise their religious affiliation in the public sphere and to manifest their beliefs by way of conducting religious observances amongst other things. The SA Constitution allocates the following privileges under the Bill of Rights to churches as juristic persons:

- guaranteed free exercise of religion
- freedom of assembly and association
- the right to self-determination of religious communities

Section 15(2) provides that the conducting of such religious observances must be according to appropriate rules made by public authorities. SACRRF (2016:41) further explains that religious organisations may not deliberately conduct themselves in an illegal manner such as performing or forcing members to perform acts or rituals that can cause harm physically or damage and/or destroy property. The SA Constitution (1996) makes provision for the CRL Rights Commission whose primary mandate includes promoting respect for the rights of cultural, religious and linguistic communities.

The SA Constitution further states persons belonging to a cultural, religious, or linguistic community may not be denied the right to enjoy their culture, practise their religion, and use their language, provided that such practices do not impede on anybody else's rights contained in the Bill of Rights (SA Constitution, 1996:13).

It follows therefore, that religious organisations ought to follow the laws of the land, including those administered by SARS, as a public authority, in relation to the registration for tax purposes and compliance to the laws governing the tax exempt status.

The focus of this research is on the PBAs as conducted by religious organisations**.**

6. Cultural

South Africa is a country characterised by a rich and diverse cultural heritage and therefore the SA Constitution (1996) guarantees and protects everybody's right to use their own language and their participation in cultural life of their choice is also protected as long as it is done so consistent with the Bill of Rights. NDP 2030 (2012:36) acknowledges that arts and culture allow for debate on the direction of the society and

if promoted effectively can contribute towards small business development, job creation, and urban development and renewal.

7. Conservation, environment, and animal welfare

The SA Constitution (1996) gives the right to an environment that is not harmful to the health or wellbeing of citizens and places the onus on the government, through legislation and other measures, to protect the environment not only for the current but also for future generations. Although the contributions of NGO's aren't well documented as a sector, they play a vital part in preserving South Africa's biological diversity. They can assist governments in achieving conservation goals in a variety of ways, including habitat and species conservation, environmental education, and skills development, functioning as watchdogs for society in terms of ecologically hazardous practices, assisting in the establishment and implementation of effective policies and laws, advancing research, and encouraging responsible consumption and business practices (Taylor, Davies-Mostert, Friedmann & Patterson-Abrolat, 2019:1)

8. Research and consumer rights

Agricultural, economic, educational, industrial, medical, political, social, scientific, and technical research are all examples of research which form part of public benefit activities exempted from tax together with the promotion and protection of consumer rights, and the enhancement of product control and quality (Income Tax Act, 58 of 1962).

9. Sport

Sanders *et al.* (2012:789) note that sports is no longer seen as a mere form of recreational activity but is now regarded as a means of development, providing extrinsic value in the field of social issues such as education, health and peace. Sanders (2010:42) writes that sport can be used as an educational tool for the youth and benefits the society while the participants can still experience a quality and guided sports activity. The NGO sector is but one of the actors involved in the sport for development industry alongside the state.

10. Providing of funds, assets, or other resources

Organisations donating funds, assets, services, or other resources to a PBO will, subject to conditions, qualify for a tax exempt status (Income Tax Act, 58 of 1962).

11. General (lists as few sub-activities).

There are other ancillary activities under paragraph 11 which qualify for a tax exempt status, subject to conditions (Income Tax Act, 58 of 1962).

3.5. Compliance status of religious organisations in South Africa

The introduction of the Non-Profit Organisations Act 71 of 1997, created an enabling environment for the NPO sector to maintain and improve standards of good governance, transparency, and accountability. This was the state's endeavour to provide a regulatory dispensation while also allowing a degree of freedom and autonomy, thus allowing the sector to be self-regulatory (DSD, 2009:4; ICNL, 2017:1; Wyngaard & Hendricks, 2010:1). A Code of Good Practice (hereafter CGP) issued in 2001 was in part mandated to encourage good governance, effective management, and ethical behaviour pursuant to the self-regulation framework of the sector. The rationale behind the CGP was that it should not be prescriptive, but rather encourage NPOs to use those aspects that they find useful and relevant to them. However, this code is voluntary and not enforceable and thus there are no compelling provisions within the code to which the NPO can be held accountable. (DSD, 2001; DSD, 2009:4).

A study conducted by the DSD (2009:11) to assess the practical implementation of the CGP in the sector, found that the compliance related to reporting requirements was still low, perhaps because NPOs believe that there are no consequences for failing to report. Monyane (2014:23,24) notes that there is insufficient research on whether any organ of the state has implemented an effective system to monitor and evaluate non-profit organisations in South Africa and the NPO Act (71 of 1997) makes no reference to such. There is also no research suggesting the implementation of Section 30(3C) of the Income Tax Act (58 of 1962) regarding collaboration between SARS and the DSD on matters of reporting delinquent organisations.

In the financial year 2015/2016, there were 153 677 organisations registered as NPOs, an increase from 136 453 recorded in the previous financial year. By the end of the financial year, only 20 percent (30 681) of the registered NPOs had submitted annual reports (a narrative report, annual financial statements, and an accounting officer's report) to the Directorate (DSD, 2016:4-5). There were about 19 585 (12.7 percent) religious organisations registered as NPOs in the 2015/2016 financial year, and of these, 8 975 were not compliant with Section 17, 18 and 19 of the NPO Act (71 of 1997). The non-compliance level in the religious sector is 54 percent (DSD, 2016:4-5).

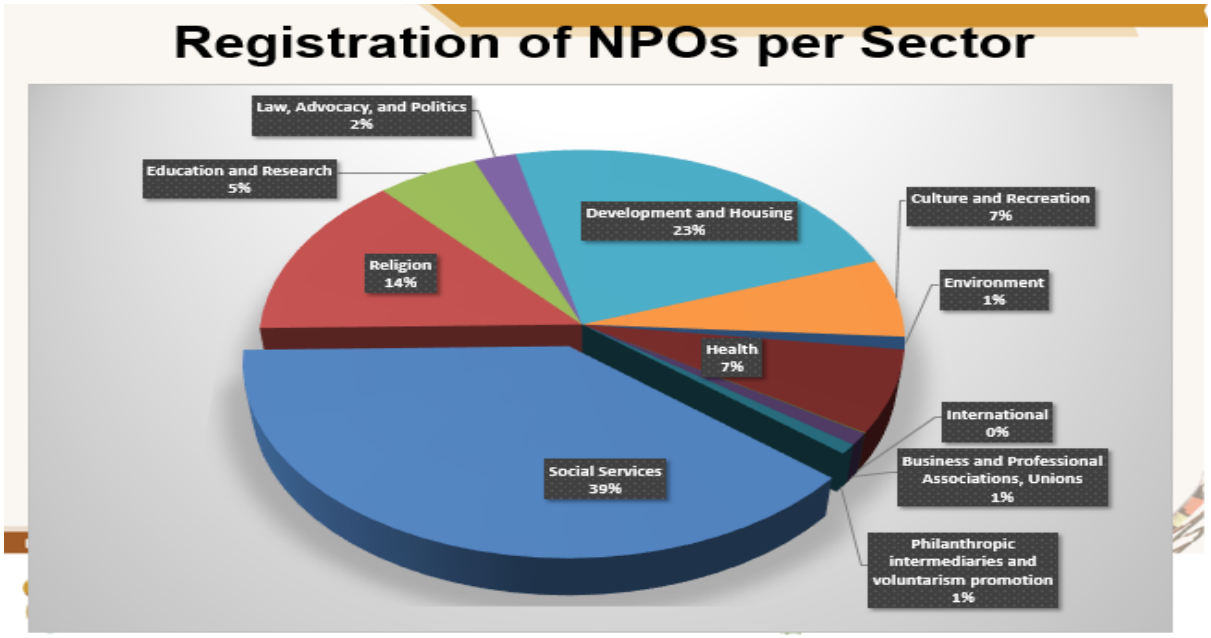
Figure 3.1 below depicts the NPO non-compliance numbers in various sectors for the 2015/2016 financial year, of which religious organisations present 39.65 percent of registered organisations and 51.8 percent (31 531) being non-complaint. There is general non-compliance in all sectors (DSD, 2016:20).

Figure 3.1- Compliance and non- compliance by sector. Source: DSD, 2016

Sector	Non-compliant	Compliant
Business and Professional Associations, Unions	626	785
Culture and Recreation	5 226	4 282
Development and Housing	19 394	13 581
Education and Research	6 472	3 515
Environment	1 054	689
Health	8 889	3 577
International	55	44
Law, Advocacy, and Politics	2 003	1 574
Philanthropic intermediaries and voluntarism promotion	908	483
Religion	10 610	8 975
Social Services	31 531	29 394
Totals	**86 768**	**66 899**

In a presentation to the Portfolio Committee on Social Development on 22 August 2018, it was reported that as at 22 February 2018, there were 188 548 registered NPOs in South Africa, of which 83 126 were found to be non-compliant (53.2 percent). Religious organisations were in the top three, accounting for 14 percent of the registered NPOs as at February 2018 (DSD, 2016; DSD, 2018a).

Figure 3.2 - Registration of NPOs per sector. Source: DSD, 2018a



The standing Committee on Social Development reported in a meeting held on 26 May 2020, that there were 228 822 NPOs registered in South Africa, of which 58.44 percent (133 724) were non-compliant with the relevant legislation (DSD, 2020).

The information presented above is an indication that there is extensive non-compliance to the legislation in the NPO sector. There could be several factors influencing the non-compliance, ranging from the belief that there is neither incentive nor consequence for failure to comply, the lack of capacity, the fragmented reporting lines, as well as the limited capacity of the DSD to monitor the organisations (Burger *et al*., 2018:13; DSD, 2009:12).

3.6. Conclusion

The aim of this chapter was to provide an overview on the development of the NPO sector and the legislative framework that governs it, with particular focus on the PBOs, specifically the religious organisations. An overview on the corporate governance principles and the compliance status of the sector formed part of the discussion.

The chapter was limited primarily to the tax legislation provisions governing the sector, the NPO Act (71 of 1997), while briefly touching on the provisions of the SA Constitution (1996) and the Companies Act (71 of 2008) that relate to PBOs and religious organisations. The intention was to include the history of the sector and its role, past and present, in order to have insight into the current regulation of the NPO/PBO sector from a legal and taxation perspective.

The NPO/PBO sector has undergone fundamental transformation since the advent of democracy in 1994 and has had to re-evaluate its stance in the development of the democratic state, as discussed in section 3.2.1. NPOs generally work toward benefiting society and human welfare or improving the world without the explicit intention to generate profit. The vindictive laws in operation during apartheid forced many organisations to operate under covert conditions. While this worked under a government notorious of intolerance towards dissent, it proved a challenge under the newly elected government as the sector was characterised by a lack of transparency and accountability as well resistance to co-operating with the authorities when it came to matters of compliance and governance, as noted in sections 3.2 and 3.2.1.

As indicated in section 3.4.3, the state acknowledges the critical role that the sector plays as a strategic partner to the state and its organs and has endeavoured to create

an environment supportive of the sector's goals in order to ensure that there is growth and development. This is primarily the reason for the tax benefits extended to non-profit organisations offering a PBA to the public.

Although there has been progress made towards formalising the sector in order to increase accountability and good governance, there is evidence that there are still gaps in the compliance to the regulating legislation (This is discussed in detail in Chapter 5). One of the challenges, is the fact that it is not compulsory or illegal for an organisation to register as an NPO, for it to operate as such, and the result of which is that an organisation can operate as a religious organisation without registration or licencing. The consequences of this are that there are no sanctions for operating without being registered as discussed in section 3.4 of Chapter 3 (Wyngaard, 2010).

From the discussion in this chapter, it can be concluded that there are legislative and regulatory mechanisms in place to govern the NPO sector. However, what is not clear, is the enforcement thereof, and if such is sufficient to prevent the non-compliance within the sector, particularly the religious sector. Although the overhaul of the tax legislation, as discussed in section 3.2.1., had a positive impact on the development for the sector, there were also unintended consequences to regulating the NPO sector as a homogenous group, without differentiating religious organisations, particularly the church, from traditional NPOs. Goodchild (2016:102) notes that the stance of NPOs and churches as well as the regulation thereof, including government's role in the regulation is limited and hardly understood and the diversity of these organisations presents a challenge in pinpointing the exact applicable law. It is the stance of the researcher that religious organisations are unique in their character and should therefore have a set of tax exempt provisions specifically applicable to them.

There is value in applying principles of good corporate governance which is aimed at supporting ethical and effective leadership. The organisations within the NPO sector can derive benefit by the application of King IV which can augment credibility and reputation and thus improve chances of accessing funding from various sources. It would therefore benefit religious organisations to follow the principles of corporate governance.

The next chapter will contain a comparison of the South African and the USA legislation governing the tax exemption criteria pertaining to religious organisations, with specific focus on the church.

CHAPTER 4: LITERATURE REVIEW: A COMPARATIVE ANALYSIS OF THE TAX EXEMPTION CRITERIA FOR RELIGIOUS ORGANISATIONS IN SOUTH AFRICA AND THE UNITED STATES OF AMERICA.

4.1. Introduction

The aim of this chapter is to review the tax exemption provisions applicable to religious organisations in South Africa and to conduct a comparative analysis with religious organisations in the USA. A synopsis of the influence of the Pentecostal movement on the Charismatic Christian church and its influence on the South African church is provided in order to provide context for why the USA is suitable for the comparison as per the secondary objective in section 1.3.2 in Chapter 1.

4.2. The influence of the USA Charismatic movement on South African Christianity

The Charismatic movement has roots in Pentecostalism, whose foundations can be found in American Evangelism, a movement that arose in the USA within the minority black Christian evangelicals (CDE, 2008:10; Coleman, 2000:20; Lauterbach, 2019:113; Mathole, 2005:181-182; Pondani, 2019:32-33). According to Coleman (2000), Charismatic Christianity is characterised by three aspects, which are:

1. disseminating its ideas using mass communications media.
2. promotion of internationalisation through global travel and working conferences as well as the operation of mega-churches which function like international corporations.
3. having a transnational culture across the globe which goes beyond location and denominations.

The broader evangelical movement has developed over decades in South Africa and there are close ties to the American Charismatic churches contributing to the Christian faith of the country. The influence of the American charismatic church is palpable in South Africa, with many of the leaders of the charismatic church in America broadcasting widely on our TV programmes (Coleman 2000: 27-28; Mathole, 2005:178, 239).

The patterns found in the American Charismatic church, which are mirrored in charismatic churches in South Africa, as well as the historical links between them, is the main motivation for choosing the USA for a comparative analysis of the tax exemption regime for religious organisations, with specific reference to the church. Moreover, the

tax exemption qualifying criteria for churches and religious organisations under Section 501(c)(3) of the USA Internal Revenue Code of 1986 (hereafter IRC) is similar to that available to PBOs, of which churches form part of under Section 10(1)(cN), Section 30 and the Ninth Schedule to the Income Tax Act (58 of 1962).

The chapter will review the criteria for tax exemption for religious organisations by SARS and compare that against the criteria used by the Internal Revenue Service (hereafter IRS) in the USA.

4.3. A review of the South African PBO tax exemption regime

Prior to the amendment of the current PBO legislation, the tax benefits granted to PBOs were limited and the laws were ambiguous and heavily reliant on the discretionary powers of the SARS Commissioner as discussed in Chapter 3, section 3.2.1. The Katz Commission (1999), in reviewing these provisions, recognised the shortcomings in the limited tax benefits extended to the non-profit sector and recommended extending greater tax benefits to the sector.

The South African law does not have a definition for a church or a religious organisation. Any organisation purporting itself to be involved in the advancement or exercise of religion qualifies to apply for the tax exempt status as per the provisions of the Ninth Schedule to the Income Tax Act (58 of 1962). It is to be noted that a PBO is not automatically exempted from taxation by virtue of carrying out one or more PBAs and not having a profit motive. An organisation would have to apply to the SARS Commissioner and satisfy all the criteria before being granted approval as a tax exempt organisation. It remains the responsibility of the organisation to ensure that they continue to comply with the relevant requirements and conditions as set out in Section 10(1)(cN) and Section 30 of the Income Tax Act (58 of 1962).

4.3.1. Separation of church and state

Henrico (2019:5-6) mentions that the United States is regarded as a symbol of democracy, equality, and justice to many nations but is also known for being a secular nation. This symbol is attributable to the establishment clause which advocates for the separation of the state from any religious association or the practice thereof. The SA Constitution (1996) guarantees citizens and religious organisations alike the right to enjoy and exercise freedom of religion (Henrico, 2019:2). Henrico (2019:3) attests that prior to the constitutional dispensation, religious faiths were still not restricted from freely

expressing and exercising their beliefs, through being subject to the regime's decrees, although certain church bodies were affiliated with the apartheid government and gave their spiritual approval of the legislature's position on racial segregation, as divine law, thus creating no demarcation between state and religion. This view is supported by Van der Borght (2011:316) and Cilliers (2006:6) who assert that there is an established and preferred view that the church and state in South Africa previously operated in unison, as evidenced by the fact that the church had great influence on state policies such as the enforcement of Christian National Education which promoted Calvinism in education. The state was seen as an arm of the church, under God's supremacy (Coertzen, 2008:346; Dreyer, 2007:41). Kuperus (1996:3) maintains that the state and the church were practically and socially indistinguishable with the church following the state's lead.

Henrico (2019:3) further articulates that the effect of the South African constitutional dispensation was that organisations simply continued pursuing their spiritual objectives, though not for partisan motives, as it was during apartheid. The most significant value of the constitutional dispensation is that all religions have protection for their faiths and are to be accommodated under the constitutional principle of religious freedom.

Unlike in America, the SA Constitution (1996) does not contain an official "establishment clause" which ensures a separation between the state and religion. However, it can be deduced that this separation does exist as evidenced by the absence of any indication of state intervention in religious freedom affairs. The national policy on religion and education (DOE, 2003) supports this stance in Clause 5, which states that in pursuit of the guarantee of freedom of religion, the state will neither advance nor prohibit religion. This policy asserts that although the government acknowledges and respects all religions and spirituality in its multifaceted expressions, it does not impose these on the citizens (Henrico, 2019:3-5). It is reckoned that there are significant comparisons that can be made between western democracies such as the USA and a young democracy that is South Africa, in terms of ensuring religious freedom - a right for which the state must abstain from interfering (Henrico, 2019:7). This is testament that there is a separation between the state and religion in South Africa.

4.3.2. Public benefit organisation requirements

Section 30(1) of the Income Tax Act (58 of 1962) defines a PBO as an organisation whose sole or principal objective is the carrying on of one or more altruistic or

philanthropic PBAs which do not promote an individual's economic interest other than by way of reasonable remuneration. The objective of the PBO should not be the persuasion of a commercial business activity with the aim of making a profit but rather for altruistic or philanthropic intent, for the benefit of the general public. It is acceptable for a PBO to undertake trading activity so long as the principal activity remains the conducting of a PBA as listed in the Ninth Schedule to the Income Tax Act (58 of 1962). Further to that, Section 30(c) of the Income Tax Act (58 of 1962) requires that for an organisation to qualify as a PBO, the activities undertaken must be freely accessible to and for the benefit of the society at large (SARS, 2017:5).

Part of the requirements for approval, as per Section 30(3) of the Income Tax Act (58 of 1962), is that the organisation must have a founding document such as a constitution, will or other written statement, which will set out specific activities including projects and programmes the organisation will undertake. It is also a requirement that this document must have three unrelated persons who will assume the fiduciary responsibility of the organisation. Furthermore, it is a requirement that the controlling powers or authority to make decisions should not be vested in one person (SARS, 2017:5-6).

The following sections discuss the terms and concepts as used in relation to the tax exemption of PBOs in the South African tax legislation.

4.3.3. Business undertaking/ trading activities

The receipts and accruals of a PBO from a non-trading activity are fully exempt other than from any business undertaking or trading activity falling outside permissible trade exemption categories, according to s10(1)(cN) of the Income Tax Act (58 of 1962). In a religious organisation, specifically the church, such receipts and accruals would comprise of voluntary giving such as tithes and offerings as well as other donations. The exemption categories have three specific provisions and a general one is discussed below.

While trade is defined in the tax legislation, there is no definition of "business". Section 1 of the Income Tax Act (58 of 1962) defines the term "trade" to include every profession, trade, business, employment, calling, occupation or venture, letting of property, and the use of or the grant of permission to use a patent, design, trademark or copyright. The definition of "business" is commonly accepted to be anything which occupies the time, attention, and labour of a person for the purpose of profit, and such activity would generally be accepted as a business based on case law. However, SARS will consider

other factors such as the intention, motive, frequency, and nature of the activity in deciding whether there is a business activity being undertaken (SARS, 2017:16). In the case of Ally v. Dinath (1984) the court held that a financial or economic motive or intention to make a profit would suffice for one to be carrying on a business.

The specific provisions which will qualify an organisation for full tax exemption under Section 10(1)(cN)(ii) of the Income Tax Act (58 of 1962) and further explained in Interpretation Note 24 (SAICA, 2016; SARS, 2018b:8-10) are as follows:

1. The business enterprise or a trading activity is (a) an essential part of and directly linked to the sole or principal object pursued by the PBO, (b) being carried out in a fashion where substantially the whole of which is directed towards recovering costs and (c) does not result in an unfair competition to other tax paying entities (Section 10(1)(cN)(ii)(aa) Income Tax Act, 58 of 1962). All three requirements must be met for the tax exemption to apply.
2. Trading activity is undertaken on an occasional basis and significantly reliant on voluntary and uncompensated assistance except for the *bona fide* reimbursement of reasonable and necessary out-of-pocket expenditure (Section 10(1)(cN)(ii)(bb) Income Tax Act, 58 of 1962).
3. A business activity approved by the Minister of Finance by notice in the Government Gazette, making consideration of the following (Section 10(1)(cN)(ii)(cc) Income Tax Act, 58 of 1962):

- "scope and benevolent nature of the undertaking or activity;
- direct connection and interrelationship of the undertaking or activity with the sole or principal object of the PBO;
- profitability of the undertaking or activity; and
- level of economic distortion that will be caused by the tax exempt status of the PBO carrying on the undertaking or activity".

According to the SARS proposed update of Interpretation Note No. 24 (2018b), the Minister has at this stage not yet approved any PBO as falling into this category. It therefore remains to be seen what activities will be approved by the Minister in the circumstances described in Section 10(1)(cN) of the Income Tax Act (58 of 1962).

4. The fourth category represents the general proviso, and it triggers tax consequences on the receipts and accruals from a business enterprise or trading activity, if the PBO conducts trade outside the permissible restrictions in the

specific exemption categories 1 to 3 above, subject to the deduction of the basic exemption from the receipts and accruals, which is the greater of 5 percent of the total receipts and accruals of the PBO or R200 000 (Section 10(1)(cN)(ii)(dd) Income Tax Act, 58 of 1962).

Paragraph (ii)(aa)(A) of Section 10(1)(cN) of the Income Tax Act (58 of 1962) stipulates that a business or trading activity undertaken by a PBO must form an integral part of or/and be directly related to the sole or principal activity of the said PBO. The SARS Guide (2017:17) explains that the concept of using the words "*sole*" in conjunction with "*principal*" in the Income Tax Act (58 of 1962) is to signify that the exclusive or predominant object must be the carrying on of a PBA, equated by the activities being physically and actively being engaged in. It is further explained that a PBO cannot have more than one sole or principal object. This sole or principal object may not be to set up a commercial activity with the aim of applying profits derived to fund a PBA listed in the Ninth Schedule to the Income Tax Act (58 of 1962).

Perhaps in trying to understand the meaning of "*integral part and directly related"* we can look at the case of Port Elizabeth Electric Tramway Co Ltd v CIR (1936), (hereafter PE Tramway) and that of Joffe & Co (Pty) Ltd v CIR (1946), (hereafter Joffe case).

- In the case of PE Tramway (1936), the company sought to deduct the legal expenses incurred in challenging the claim for compensation lodged by an employee after being involved in a tramway accident while on duty. In deciding the case, the court had to consider whether the act to which the expenditure relates was performed in the production of income and whether such expenditure was closely linked/connected to the act. The court held that the employment of drivers carries with it a potential liability to pay compensation if such drivers are injured in the course of their employment. The court allowed a deduction for the compensation paid to the dependants of the taxpayer as it was an inherent risk to the job.
- In the Joffe case (1946), the company paid damages to the dependants of an employee who had been killed due to the negligence of the company's failure to take proper precautions to prevent the structure from collapsing. The company sought to deduct the damages paid from taxable income. The court held that the negligence which caused the collapse and subsequently led to the

claim for damages was not an inevitable concomitant of the taxpayer's business and therefore the expenditure was not deductible.

The two cases are focused on the deduction of expenditure incurred under the circumstances indicated and may not be directly related to the topic at hand. However, from these two cases we can take away the principle that the actions giving rise to expenditure (subject matter in the cases) must be so closely connected (be a necessary concomitant) of the income earning activities.

This principle of the existence of a close connection, can be used to interpret the "*integral part and directly related"* as worded in Section 10(1)(cN)(ii)(A) of the Income Tax Act (58 of 1962). The trading undertaken must be an essential part of and be so closely connected to the sole or principal PBA pursued by the PBO, as contained in the Ninth Schedule to the Income Tax Act (58 of 1962). It therefore stands that a PBO cannot claim generating income from assets such as the letting of parking facilities, tennis courts or a hall, to members of the public as the "integral part and directly related" to the sole or principal PBA (SARS, 2017:16).

The second requirement to be satisfied is that substantially the whole of trading activities is directed towards recovering direct and reasonable indirect costs. SARS will usually be satisfied with 90 percent or more of the trading activities being channelled towards recovering costs, calculated using methods appropriate to the circumstances, however nothing less than 85 percent will be accepted as per the Binding General Rule 20 (SARS, 2018c:5).

The third proviso requires that the trading activity undertaken by the organisation should not result in unfair competition to other tax paying entities. A portion of the profits earned by tax paying entities go towards the payment of tax, something which a PBO is not required to do, therefore should a PBO operate in a manner akin to that of a commercial entity, this may result in unfair competition. What will be highlighted in Chapter 5, with specific reference to churches, is that some, mostly the megachurches[6], are engaged in fully fledged profitable trading activities that compete with secular tax paying businesses.

[6] According to Hartford Institute for Religion Research, a megachurch is a Christian congregation with a sustained average weekly attendance of 2000 persons or more in its worship services, counting all adults and children at all its worship locations. http://hirr.hartsem.edu/megachurch/definition.html

Section 10(1)(cN)(ii)(bb) of the Income Tax Act (58 of 1962) requires that the trading activity must take place occasionally or infrequently and be operated using resources availed on a voluntary and uncompensated basis. The organisation is permitted to incur costs towards the volunteers for the *bona fide* reimbursement of reasonable and necessary out of pocket expenses incurred by the volunteers (SARS, 2018b:9). This simply put, means that the volunteers should not be remunerated for the labour/service they provide except for reimbursement of expenses they incur out of pocket in order to provide their labour/service.

Paragraph (ii)(cc) of Section 10(1)(cN) of the Income Tax Act (58 of 1962) enables the Minister, by notice in the *Gazette*, to approve any trading undertaking that is regarded to be of a benevolent nature and closely connected to the main object of the PBO, having considered its profitability and any level of economic distortion that might arise.

4.3.4. Commercialisation and unrelated business income

Prior amendments, Section 10(1)(fA)(ii)(ee) of the Income Tax (58 of 1962) explicitly prohibited organisations from engaging in any trading activities, except to the extent as directed by the SARS Commissioner. It was the legislative reform in 2000 that permitted trading activities by public benefit organisations, within certain parameters. The *de minimus* rule and “related trading activities” were introduced by this law promulgated in 2000. The *de minimus* rule provided that the gross income derived from such business undertaking or trading activities must not exceed R25 000 or 15 percent of the gross receipts of the organisation (Nelson, 2004:206).

Prior to 2006, the trade rules governing PBOs were contained in Section 30(3)(b)(iv)(aa) of the Income Tax Act (58 of 1962) which was later incorporated into that of Section 10(1)(cN) of the Income Tax Act (58 of 1962). Prior to this change, a PBO would either qualify for full exemption from income tax subject to certain limitations and where its trading income exceeded certain thresholds it would be liable for income tax on all income derived by it.

The Income Tax Act (58 of 1962) as amended in 2006, implemented the concept of partial tax exemption thereby allowing PBOs to retain certain trading activities without jeopardising their tax exempt status. Section 10(1)(cN) of the Income Tax Act (58 of 1962) refers to various categories of trading activities, discussed in section 4.3.3 above.

The PBO is required to invest its surplus funds in specific prescribed investments under Section 30 of the Income Tax Act (58 of 1962). Because the investment of surplus funds

is not recognised as carrying on a business or trade, the income earned from those investments will normally be tax free (SAICA, 2016). Section 10(1)(cN) of the Income Tax Act (58 of 1962) recognises that income derived otherwise than from any business undertaking or trading activity will not be subject to income tax. As a result, interest on bank deposits and foreign dividends on unit trusts held by a PBO, as well as related investment income, will not be taxed in accordance with the provisions of the section provided that it's not undertaken in an active manner, such as providing interest-bearing loans at market-related rates (SAICA, 2016; SARS, 2017:16).

Should a PBO conduct trading activities outside the permissible restrictions mentioned in the three specific exemption categories indicated in section 4.3.3 above, it would follow that the receipts and accruals from that business enterprise or trading activity will attract normal tax subject to the deduction of the basic exemption, which is calculated as the greater of 5 percent of the total receipts and accruals of the PBO or R200 000, deducted from those receipts and accruals in accordance with paragraph (ii)(dd) of Section 10(1)(cN) of the Income Tax Act (58 of 1962). The total receipts and accruals from all undertakings and activities are added together before the deduction of the basic exemption and the remaining receipts and accruals from undertakings or activities will be taxed. Consequently, the amount of the basic exemption threshold must be applied to the cumulative receipts and accruals of all commercial undertakings and not separately to any such undertaking or business operation (SARS, 2017:21-22).

4.3.5. Redistribution of income

Section 30(3)(b)(ii) of the Income Tax Act (58 of 1962) prohibits a PBO from distributing any of its funds to any person, other than in the course of undertaking activities, and the organisation must utilise funds solely towards the objective for which the PBO is founded. Upon dissolution of a PBO, all assets must be transferred to an approved PBO conducting similar activities or another institution, board or body which is exempt from tax under the provisions of Section 10(1)(cA)(i) of the Income Tax Act, whose sole or principal object is the carrying on of any PBA, or to any arm of the state, be it in the national, provincial or local sphere of government.

4.3.5.1. Private distribution of income

Section 30(1)(b)(ii) and Section 30(3)(b)(ii) of the Income Tax Act (58 of 1962) contain the private distribution prohibition, similar to that which is found in the USA legislation for tax exempt organisations. This prohibition provides that no PBA may be undertaken

to promote the economic self-interest of any of those who exercise control over the PBO either directly or indirectly, other than payment of reasonable remuneration and funds may not be distributed to any person but should be expended solely for the purpose for which the organisation was established (Income Tax Act, 58 of 1962).

4.3.5.2. Reasonable compensation

The exception to the private distribution prohibition above is for the payment of what is considered reasonable remuneration. Paragraph (3)(b)(ii) and (3)(d) of Section 30 of the Income Tax Act (58 of 1962) extends the prohibition of payment of excessive remuneration to any employees, officials, members, or any other person and also gives guidance that the remuneration ought to be aligned to sector standards and consideration given in relation to the service offered in exchange of the compensation. The payment of the remuneration should not be used to benefit any person economically in a manner that is not aligned to the objectives of the organisation.

Ngwenya and Khumalo (2012:98) explain that economic literature has established that there should be a connection between compensation paid to senior management and the performance of a company for economic reasons. Performance of a company is usually measured by taking into account shareholder equity, share performance, and the profitability while the Chief Executive Officer's (hereafter CEO) remuneration is typically calculated in terms of a basic salary, a cash bonus, share awards, option awards and other benefits such as pensions and other incentives (Attaway, 2000:80; Bradley, 2013:539; Ngwenya & Khumalo, 2012:99) . In the 2012 study conducted on the executive performance in South Africa, Oberholzer and Theunissen (2012) discovered that compensation paid to CEOs in South Africa is excessive and that there is a positive connection between company performance and remuneration. Deysel and Kruger (2015:138) established the existence of other plausible relationships by examining the relationship between CEO remuneration and general employee compensation, company size, industry peers, overall market performance, and overall inflation.

However, unlike private companies, churches receive the bulk of their revenue from the congregants in the form of tithes and offerings (Tanui *et al.,* 2016:41). As non-profit organisations they do not issue shares and their mission is not to maximise profits. Church leaders are not answerable to shareholders; instead, they are accountable to the members of the congregations who provide the capital for the operation of the church

(Ahiabor & Mensah, 2013:116). However, judging from the flamboyant lifestyles of luxury cars, mansions, and designer clothes, led by most church leaders (Timeslive, 2019), there is a clear indication of excessive remuneration.

Bradley (2013:540) notes that due to increased disclosure requirements of the King Code of governance and the King Report, data is readily available from the annual reports of companies in order to research CEO remuneration paid to all employees. However, the King Code of Governance Principles and the King Report IV on Governance are not enforceable for religious organisations, therefore religious organisations are not legally compelled to make information on remuneration available to either the public or the congregants. It therefore is an unclear area as how the compensation paid to leaders of religious organisations in South Africa is determined, measured, and monitored. Unlike the private sector, there is no research available on remuneration policies and standards in the religious sector, making the implementation of Section 30(3)(d) of the Income Tax Act (58 of 1962) difficult.

Thus, there is a gap that exists in research to examine the measures, methods, and factors that determine the compensation paid to senior church leaders.

4.3.6. Political and lobbying activities

Van der Vyver (1999:635-639) relays the constitutional history of South Africa as being one of an institutionalised racist structure with a distinct bias in favour of a certain brand of Christianity. So involved was the state in religion, that the constitution prior to 1994 contained a confession which proclaimed, *"The people of the Republic of South Africa acknowledge the sovereignty and guidance of Almighty God".* Some of the laws in place during the pre-democracy era authorised state interference in religion, such as the Church Clause which proposed to limit black people to only attend church services in areas allocated to them under the Group Areas Act[7]. Mafuta (2016:1) states that some churches responded by delegitimising the government while others like the Dutch Reformed Church sacralised and sided with the Government. The separation of state and religion in South Africa is discussed in section 4.3.1 above.

South Africa's constitutional reform, which took effect on April 27, 1994, was structured to innovate social, political, and legal systems that would vary dramatically from those of the history of the country. In that sense, the new constitutional dispensation emanated

[7] Legislation that authorised forced removals of black South Africans from residential areas and their resettlement to places outside the periphery of white urban communities

from a reactionary response to the preceding era's injustices (Van der Vyver, 1999:640-643).

Section 30(3)(h) of the Income Tax Act (58 of 1962) prohibits any PBO from utilising its resources in support, advancing, or opposing of any political party whether directly or indirectly. However, given the prominent role that religious organisations played in shaping the political landscape in South Africa, both pre- and post- apartheid, the state as represented by the ruling party, the African National Congress (ANC) and other law makers in parliament such as the African Christian Democratic Party (hereafter ACDP), finds itself more often than not, entangled in religious matters (Bailie, 2019; SABC News, 2018). Hexham and Poewe (1994:52) noted that politicians of all positions had a tendency to lobby megachurches for support and this tendency was not only unique to South African but was also observed in the USA and Canada. While the church leadership disliked and occasionally detested this lobbying, it was permitted.

4.3.7. Sanctions for non-compliance

Compliance with the conditions of Section 10(1)(cN) and the requirements of Section 30 of the Income Tax Act (58 of 1962) will ensure that PBOs continue to enjoy tax exemption status. In accordance with Section 30(5) of the Income Tax Act (58 of 1962) failure to comply with these provisions or non-compliance with the founding documents of an organisation may result in the SARS Commissioner withdrawing the tax exempt status from the PBO, if corrective steps are not taken subsequent to being issued with the notice of intention to withdraw the approval.

An organisation whose tax exempt status has been withdrawn, must transfer or take reasonable steps to transfer all remaining assets to any other PBO, institution, board/body, or government within six months of withdrawal or for as long as this is allowed by the SARS Commissioner. Any assets not transferred within the prescribed period, may be deemed to be an amount of taxable income accrued to the organisation, at the market value of such assets.

Paragraph 11 of Section 30 of the Income Tax Act (58 of 1962) stipulates that it is an offence for a fiduciary tasked with the management and control of the PBO’s income and assets, to intentionally fail to comply with any provision of Section 30 of the Income Tax Act (58 of 1962) or any provisions in the founding documents, the conviction of which can attract the imposition of a fine or imprisonment for up to two years.

4.4. A review of the USA religious and church tax exemption regime

The tax treatment of the non-profit sector in the USA balances on the dual principles of federalism and fiscal incentives which have enabled organisations in this sector to assume numerous roles such as innovative service providers, funders, and influencers of their local and global social programmes. The established policy which sets out objectives, and accountable and flexible standards supporting charitable giving is nurtured by the preferential tax treatment of non-profit organisations in the USA (the "US model"). The US model for the tax treatment of NPOs has become a preferred model and is regarded as suitable for emerging non-profit organisations throughout the world. Despite its popularity and the guidance it offers for laws governing non-profit organisations, it can never be a single universal template for all nations (Lieber, 2004:173).

The fiscal policy which encourages philanthropic activity by both individual and corporations in the USA through an incentivised legal system offers positive tax exemptions and deductions. This two-tier mechanism has provided objective legal standards which have created an enabling infrastructure for the non-profit sector (Lieber, 2004:173-174). Tax exemptions are afforded to various organisations including charitable, religious, and educational organisations and a host of other organisations.

4.4.1. Separation of church and state

King (1999:975) indicates that the theory of the "wall of separation" between the state and the church relies on the historical context that the separation protects and maintains religious freedom from the political sphere, thus ensuring the sovereignty of each institution. This view of the separation of church and state was expressed by Thomas Jefferson in a letter he penned to the Danbury Baptist association in 1802, in which he described America's First Amendment's protection of religious freedom as building a wall of separation between church and state. The USA has practiced the separation of church and state by the exemption of churches from federal taxes since the founding era (King, 1999:972; Martin, 2017:311).

In the case of Walz v. Tax Commission (1970), the US Supreme Court rejected claims from a realty owner that the property tax exemption granted to churches was an unconstitutional establishment of religion. The realty owner had argued that the tax exemption created an indirect financial contribution to the church. The court rejected the

reasoning that the financial contribution would connote sponsorship, financial funding, and active involvement of the government in the religious activities and referred to the "unbroken practice" by the state to exempt the church from taxes since the founding of the US (Martin, 2017:313, 316-317).

Martin (2017:317) notes that taxing the church or not taxing it inevitably places the state in a position of entanglement. The court weighed between two alternatives whereby granting the tax exemption to churches provides religious organisations with an indirect economic benefit over those whose purpose is to make profits and imposing taxes on churches would raise direct instance of excessive entanglement between the state and religion. In concluding the case, the Supreme Court held that the tax exemption created a marginal and remote involvement that was far less than if the government were to impose taxes on religious organisations. It held that there is no genuine nexus between the tax exemption and the establishment of religion (Martin, 2017:317).

Witte (1991:364) states that in the case of Walz v. Tax Commission (1970), the Supreme Court of USA mapped a passage between the establishment and the free exercise clause and upheld the constitutionality of state property tax exemptions. He explains that the establishment clause and the free exercise clause have been interpreted to prohibit the state from advancing special benefit to or imposing any special burdens on religious organisations. He argues that the taxation of or the exemption of religious organisations will satisfy neither of these clauses. The argument is advanced by the observation that the exempting of church property and taxing of non-religious groups breaches the prohibition of special benefits contained in the establishment clause, while taxing the church property and exempting all other non-profit organisations would contravene the prohibition of placing special burdens on the church contained in the free exercise clause (Witte, 1991:364).

4.4.2. Religious organisation and church tax exemption

A wide set of purposes under which organisations become eligible for exemption from federal taxes are defined under Section 501(c) of the IRC (1986), with some purposes enumerated in law and some included by implication of using the term "charities" derived from the English common law (Westenberger, 2014:227-228). Amongst the listed purposes for tax exemption under Section 501(c)(3) of the IRC (1986) is the advancement of religion.

The USA federal tax system distinguishes a church from religious organisations. A church is not a defined term although it is generally used to refer to places of worship while religious organisations include non-confessional and ecumenical organisations whose primary purpose is to study or advance religion. State laws allow for churches and religious organisations to be legally structured in a number of ways such as unincorporated societies, non-profit companies, single companies, and charitable trusts (IRS, 2015:1)

Churches are exempted from a certain of taxes levied by the government under Section 501(c)(3) of the IRC (1986). Brown (1990:1631-1633) argues that the principal reason for exempting an organisation from the payment of tax is that the organisation provides benefits to the society at large and their activities not only benefit those who operate it, or those to whom it provides services, although there is debate on the scope and administration of the tax exemption extended to religious organisations. The view is supported by Westenberger (2014:228-229) who states that the *sine qua non* of a non-profit organisation is the objective to serve a public purpose rather than a private purpose.

Brown (1990:1634) states further that the reason the government forgoes tax revenue that would have been collected from non-profit organisations, is to encourage them to continue to deliver the public benefits which benefit the government as well. In the Walz v. Tax Commission (1970) case, the Supreme Court held that the public benefits provided by religious organisations constitute a beneficial and stabilising force in civic life and promote diverse views and viewpoints that lead to a vibrant, pluralistic society. If a non-profit organisation clearly exhibits the hallmark activities of for-profit organisations, courts may conclude that it is driven by a significant commercial intent, which may lead to a denial of the exemption, despite there being an exempt purpose which is supported by commercial activity (Colombo, 2002:497).

Unlike churches, which qualify for automatic tax exemption if they meet the requirements of Section 501(c)(3) of the IRC (1986), religious organisations that wish to be tax exempt must apply to the IRS to be granted the tax exempt status, unless their gross receipts do not typically exceed $5,000 a year (IRS, 2015:2-3).

In accordance with Section 501(c)(3) of the IRC (1986), there are two specific requirements to be met by religious organisations in order for the IRS to determine whether the entity meets the religious intent standards, which are:

- The religious beliefs themselves are truly and sincerely held.
- The practice and rituals associated with the organisation's religious belief or creed aren't illegal or contrary to clearly defined public policy.

Additionally, since a church is not defined, the IRS has developed and uses the following criteria determine what is considered to be a church (Busby , Laue, Martin & Van Drunen, 2019; IRS, 2015):

1. A distinct legal existence.
2. A recognised creed and form of worship.
3. A definite and distinct ecclesiastical government.
4. A formal code of doctrine and discipline.
5. A distinct religious history.
6. A membership not associated with any other church or denomination.
7. Ordained ministers ministering to its congregants.
8. Ordained ministers selected after completing prescribed studies.
9. A literature of its own.
10. Established places of worship.
11. Regular congregations.
12. Regular religious services.
13. Sunday schools for religious instruction of the young.
14. Schools for the preparation of its ministers.

The determination as to whether an organisation is a church is done on a case-by-case basis taking into account the merits of each case. No single factor determines the answer and not all factors ought to be present in order for an organisation to be determined as a church (Busby *et al.,* 2019).

Churches which meet the criteria of Section 501(c)(3) of the IRC (1986) are automatically considered tax exempt and are not required to apply for and obtain tax exempt status designation from the IRS. However, many churches still apply for the tax exempt status recognition from the IRS, even though it is not required. This is because it gives assurance to the church leaders, members, and contributors that the church is recognised as a tax exempt organisation and qualifies for relevant tax benefits and that their contributions are normally tax deductible (IRS, 2015:2). Both the church and religious organisations must abide to the following provisions of Section 501(c)(3) of the IRC (1986) in order to qualify for tax exemption (IRS, 2015:2):

1) organisations must be organised and operated exclusively for religious purposes;
2) the net earnings may not flow or be distributed for the benefit of any private individual or shareholder;
3) prohibited from having substantial lobbying activities in an attempt to influence legislation;
4) should not intervene in political campaigns; and
5) purposes and activities must be legal and should not violate public policy.

The following sections will break down the terms as used in Section 501(c)(3) of the IRC (1986) tax exemption requirements for religious organisations.

4.4.3. Exclusively operated for exempt purposes

Section 501(c)(3) of the IRC (1986) provides that an organisation may qualify for exemption from federal tax if it is organised and operated solely for charitable purposes. The tax exemption is motivated by the fact that if the state would have had to provide such services or tasks, it would have paid for them (Maram, 2008). In determining whether an organisation should be exempted from tax or not, “organisation” and “operation” tests are used, and the organisation needs to gratify both tests.

The organisational test assesses the appropriateness of the organisation's purposes and the powers granted to it through its founding articles, while the operational test is concerned with the activities undertaken by the organisation. The term “articles” refers to the trust instrument, corporate charter, articles of association, or any other written instrument that establishes an organisation (Blazek, 2012:29; Moffat & Ankersen, 2015:4).

To satisfy the organisational test, the founding articles must express explicitly that the organisation is established to carry out one or more exempt purposes listed in Section 501(c)(3) of the IRC (1986). As such, the primary activities must be directed towards the exempt purpose(s) for which it is established except if such other non-exempt purpose activities form a negligible part of the overall activities performed by the organisation. A significant non-exempt activity can lead to the rejection or withdrawal of the tax exempt status. In addition to examining the organisation’s purpose, the financing sources, constituency, and nature of expenses will be called as evidence to the operational test (Blazek, 2012:32, 35-36).

While the organisational test looks at what the organisation states in its documents, what it does or aims to do is tested by the operational test. To satisfy the operational test, an organisation must operate primarily for one or more of the exempt purposes specified in Section 501(c)(3) of the IRC (1986) rather than operating for a private purpose with the intention to promote the founders' personal interests (Blazek, 2012:35-36; Moffat & Ankersen, 2015:8).

4.4.4. Redistribution of income

Hansmann (1980:838) indicates that one of the defining characteristics of non-profit organisations is the prohibition against the distribution of profits or the utilisation of the organisation's income or assets for the benefit of any individual who exercises control over it, be it direct or indirectly, a doctrine referred to as private inurement. The non-distribution constraint requires that surplus funds retained in the organisation must be dedicated to the continuation of the tax exempt purposes (Brown, 1990:1635; Gilman, 2002:823; Gomes & Owens, 1988:10).

4.4.4.1. Private inurement

The requirements of Section 501(c)(3) of IRC (1986) are that in addition to being organised and operated exclusively for religious, charitable, or educational purposes, there is a prohibition on distribution of the organisation's net income, meaning that it should not be distributed to or for the benefit of any private stakeholder or individual who exercises control over the organisation, often referred to as "insiders". The essence of the private inurement doctrine is to ensure that charitable tax exempt organisations operating under Section 501(c)(3) of the IRC (1986) pursue and serve public rather than private interests and acts as a functional dividing line between non-profit and for-profit companies (Arnsberger, Ludlum, Riley, & Stanton, 2008:107; King, 1999:980; Manny, 2000:6).

Westenberger (2014:230) also states that in general, there are two differentiating factors between the doctrines of private inurement and private benefit. Firstly, an incidental amount of private benefit does not generally imperil the tax exempt status of an organisation but the violation of the prohibition of private inurement is statutorily absolute. Secondly, is that while the private benefit principle is applicable to any recipient of undue benefit, the prohibition on private inurement only extends to individuals having a considerable degree of influence over the organisation, such as trustees, officers, or main employees.

The IRC Section 4958 (1986) calls for excise taxes to be imposed on excess benefit transactions between disqualified persons and tax exempt organisations (excise taxes are discussed in section 4.4.7). Section 4958 (c)(1)(A) of the IRC (1986) describes an excess benefit transaction as one where the value of the benefit provided by the organisation exceeds the value of what the person provides the organisation in return. Disqualified persons are defined in Section 4958 (f)(1) of the IRC (1986) as persons who are or were in the previous five years before the transaction in question, in a position to exercise substantial influence over the organisation's affairs, including directors, officers, and key employees as well as their related families or entities where more than 35 percent is controlled by a disqualified person (IRC, 1986; Levitt, 2009:14). Leff (2015:27) relays that the aim of the private inurement rule is to identify tax exempt organisations who are overcompensating individuals within the organisation who have significant influence over the financial affairs of the organisation.

The private inurement and private benefit doctrines found in Section 501(c)(3) of IRC (1986), along with the related intermediate sanctions regime under Section 4958 of the IRC (1986) are the key enforcement tools that the IRS and the courts may use to regulate financial abuses by tax exempt organisations (Manny, 2000:6; Westenberger, 2014:228-229,233).

4.4.4.2. Reasonable Compensation

Hansmann (1980:838) clarifies that the organisations are not barred from paying a reasonable compensation to employees for labour or investment provided, irrespective of whether such payment is to an individual who exercises control over the organisation. While this is permitted, there is always a risk that non-profit organisations may succeed in distributing income to their founders or related through excessive salaries and other undue benefits granted to founders and/or employees (Hansmann, 1980:844,874-875).

Section 162(a)(1) of the IRC (1986) allows for the deduction of remuneration paid or accrued limited to an amount deemed to be reasonable. The IRS will classify any amount deemed to exceed reasonable remuneration as a dividend payment which is not allowed as a deduction from taxable income. Any amounts deemed to be in excess of reasonable compensation raises the real character of the excessive non-deductible portion (Englebrecht, Holcombe & Murphy, 2014:233; Sikon, 2004:301-302).

The question of "reasonability" is the underlying problem when it comes to the amounts paid as compensation (salaries). The deduction for salaries paid to employees will rarely

be questioned by IRS if done in an objective manner and is at arm's length, with the amounts determined to be proportionate to the value the employee brings to the organisation. The problem of the deductibility of salaries arises where the person, who influences the decision on the payment of salaries, is being paid a substantial amount. A decision must then be made as to whether the compensation is reasonable, or if it is an attempt to distribute the earnings of the organisation to that person, which would render that expense not deductible (Rogers, 1968:119).

Englebrecht *et al*. (2014:233) record that the reasonableness of compensation has been a disputed issue in the US and the US Tax Court is frequently faced with litigation cases involving reasonable compensation. The disputes stem from the fact that there are no conclusive criteria for determining "reasonableness" of compensation. Rogers (1968:120) contends that although the factors taken into consideration to determine whether remuneration is reasonable or not have proven easy to learn, it is their application to a factual situation that proves to be difficult, hence each case is considered on its own specific set of merits which will decide if the compensation in question is "reasonable".

The US courts have developed guidelines with the following factors used to assist in making a judgement regarding the reasonableness of compensation (Englebrecht *et al.,* 2014:234-235; Rogers, 1968:120):

1. The nature of services rendered, the scope and extent thereof;
2. the scarcity of the qualification required by the position, employee's qualification (expertise and experience) and prior earnings' capacity and the value added by the employee to the organisation;
3. the employer's remuneration policy;
4. the organisation's gross and net earnings in comparison to salaries paid;
5. the nature, size and complexity of the organisation as well as its location;
6. rates of remuneration for performing similar functions within the organisation and those in comparable organisations (industry comparison);
7. an arm's length transaction and conflict of interest;
8. the previous years' remuneration bill;
9. the general state of the economy;
10. a comparison of salaries with distributions to shareholders (dividend history).

The IRS considers the above factors to positively contribute to classifying sums reported as reasonable compensation by an organisation. However, each factor and the evidence in support for or against the deduction cannot be considered in isolation. It is common for an organisation to deduct salaries from taxable income as opposed to declaring the expense as dividends. This is due to the fact that while salaries are deductible as an expense to reduce tax liability, dividends are not (Englebrecht *et al.,* 2014:235). The onus for proving the deductibility of the amount lies with the organisation and the organisation has an opportunity to rectify the excessive portion of the compensation or prove that the amounts are not excessive during the appeal process or in court (Rogers, 1968:121).

Sikon (2004:302) cautions that there has been inconsistent treatment of the amounts deemed unreasonable where in some instances the amounts were re-characterised as something other than compensation such as dividends, citing the principle of *substance over form,* and at other times this was not done, and the employer was held bound by the original classification of the transaction.

4.4.5. Commercialisation and unrelated business income

Colombo (2002:489) reported on the trend of non-profit organisations engaging in commercial activities and acting in a manner that mirrors the for-profit organisations, such as the increased number of churches seen to be opening restaurants including Starbucks franchises and private gyms. Bosscher (2009:1) makes a point that the tendency of commercialisation in the non-profit sector has raised questions regarding the qualities of the sector and its function in society. Young and Salamon (2002) mention that commercial enterprises have been a part of the non-profit sector since its early years and the only difference is the scope, scale and the variety of commercial activities that have occurred over the recent decades.

Section 513(a) of the IRC (1986) broadly defines trade as including any activity of selling of goods or rendering of services undertaken to produce income, irrespective whether a profit is achieved or not. Blazek (2012:627) enunciates that the courts have further expanded the definition to include trade or business to include that which is carried on continuously and regularly in a competitive manner akin to commercial business.

Prior to 1950, all income earned by tax exempt organisations from mission-related activities as well as unrelated commercial activities was not subject to tax as long as profits were ploughed back into the exempt purpose. The church continued to be tax

exempted on all income including unrelated business income until the reforms of 1969 (Arnsberger *et al.,* 2008:107-108; Blazek, 2012:624).

There are two types of income that can be derived by tax exempt organisations, these being the earned and unearned income. The unearned income is that which the organisation is not obliged to exchange anything in return for its receipt, such as donations, while there is an exchange of goods and/or services exchanged for the earned income (Blazek, 2012:622). In accordance with Section 501(a) of the IRC (1986), organisations listed under Section 501(c) of the IRC (1986) are exempted from taxation on the income derived from a trade or business activity that is substantially related to the exempt purpose while income derived from a trade or business activity which is not substantially related to the exempt purpose will trigger unrelated business income tax (often called UBIT). If one or more trades or businesses are not substantially related to the exempt purpose being conducted, tax will be levied at corporate rates on the income derived from each separate unrelated trade or business. This was implemented as an attempt by the government to limit the extent to which NPOs abuse their tax exempt status by pursuing commercial activities substantially disconnected to the primary exempt purpose (Cordes & Weisbrod, 1998:197; Maram, 2008).

Brown (1990:1640) informs us that the IRS and courts apply the commercial manner test to determine if an NPO is operating in a manner akin to that of a for-profit company and therefore should not be deserving of a tax exempt status i.e., organisations that do not substantially benefit the public or organisations formed for private benefit. It is to be noted that the commercial manner test is only a check mechanism from which a comprehensive investigation can be triggered (Brown, 1990:1640-41). The following factors will be used in the commercial manner test:

1. The sales of goods and services.
2. Profit-making and accumulation of profit.
3. Competition with for-profit firms.
4. Extensive and successful expansion efforts.
5. Formal contractual arrangements.
6. Use of paid rather than volunteer workers.
7. Isolation and centralisation of organisational control.

The tax exemption status will be denied or revoked if there is substantial commercial purpose in the practices of a tax exempt organisation. These enforcement actions

ensure that organisations do not evade the payment of taxes by claiming to be operating exclusively for an exempt purpose, such as religious purpose and gaining unfair competitive advantage over other entities' operation for the pursuing of profits (Martin, 2017:334).

4.4.6. Political and lobbying activities

Section 501(h) of the IRC (1986) sets two distinct limitations on the political activities of tax exempt organisations, the first being that the organisation may not have a substantial part of its activities devoted to carrying out propaganda or attempting to influence legislation, and secondly, that the organisation may not participate in, or interfere in political campaigns in support of or in opposition to any candidate running for public office (Garnett, 2001:772; Johnson, 2001:878-879). In accordance with Section 504 of the IRC (1986), violation of these prohibitions may lead to an organisation ceasing to qualify for the tax exemption. Lieber (2004:187) asserts that the ban on setting the political agenda is a measure of ensuring that there is a separation of fiscal policy and political interests. Mayer (2009:1139) states that the established interpretation of the prohibition of non-profit organisations to participate in political campaigns is that it prevents these organisations from supporting or opposing candidates for elected public office. How substantial the activity is, will be determined by the amount spent towards this activity using the "expenditure test", where up to 20 percent towards direct lobbying and up to 5 percent on grass roots lobbying of gross expenditure is permissible. However, any activities or efforts to influence legislation, such as persuading voters to the correctness of principles held by a candidate running for public office, is absolutely prohibited (Johnson, 2001:880).

4.4.7. Sanctions for non-compliance

For an organisation to qualify for the tax exemption offered by Section 501(a) of the IRC (1986), it ought to be organised and operated exclusively for exempt purposes listed in Section 501(a) of the IRC as discussed in section 4.4.2 and 4.4.3. Furthermore, an organisation may not distribute (inure) any of its earnings or assets to any private shareholder or individual such as the clergy, board members, officers, or employees (See discussion in discussion in section 4.4.4.1). For instance, if a pastor is receiving unreasonable remuneration, that would be considered an inurement to the insider of a church and can lead to the organisation losing its tax exemption status (IRS, 2015:5).

Tesdahl (1996:20) explains that prior to the introduction of the “intermediate sanctions” in September 1995, the only punitive measure the IRS could take to penalise the non-profit organisations that violate the private inurement doctrine, such as paying excessive compensation, was to revoke their tax exempt status. Congress realised that this was a harsh sentence which often resulted in the dissolution of these organisations and ultimately deprived the public of the programs the organisation was running, while the culprit received no tangible punishment (Lieber, 2004:186; Ritchie, 1999:876).

The regulations under Section 4958 allow for the IRS to impose excise taxes on the organisation’s insiders who have contravened the private inurement rule (excess benefit transaction). Ritchie (1999:879) describes an excess benefit transaction as an economic benefit provided to an insider of a tax exempt non-profit organisation, which directly or indirectly exceeds the value of services the organisation receives from that insider. A 25 percent excise tax is charged on each excess benefit transaction between the non-profit organisation and the insider provided the transaction is corrected within the taxable period (first tier) in accordance with Section 4958 (a)(1).

Failure to correct the transaction within the taxable period attracts an additional 200 percent tax on the transaction (second tier) in terms of Section 4958 (b). Correction of the excess benefit transaction entails the undoing of the value of the transaction, such as repayment of the compensation with interest back to the organisation. The regulations bring into the definition of insider anyone who is a family member of the insider or connected entities where the insider holds more than 35 percent of the controlling powers. When the 25 percent excise tax is imposed on the insider, the manager(s) who knowingly and wilfully and without reasonable cause, participated in excess benefit transactions can also have a 10 percent excise tax imposed to a maximum of $20 000, for each single transaction in accordance with Section 4858 (a)(2) (IRS, 2021; Levitt, 2009:13-15; Lieber, 2004:186; Ritchie, 1999:877-878).

4.5. Conclusion

The parallels between the USA and the South African tax legislation are that both require that in order for a church and/or religious organisation to be approved for and to enjoy the benefits of the tax exemption status, the following criteria must be met:

- All persons must be eligible to participate in its religious activities therefore private and exclusive groups cannot enjoy this preferential tax treatment (see sections 4.3.2 and 4.4.3).

- The cause pursued by the organisation should not be for the private inurement of an individual bar for what is considered reasonable remuneration for services offered to the organisation (see sections 4.3.5 and 4.4.4)
- Religious organisations are prohibited by Section 30(3)(h) of the Income Tax Act (58 of 1962) from using its resources to advance or oppose the cause of political campaigns or parties (see sections 4.3.6 and 4.4.6).

The South African PBO tax exemption legislation applies a one-size-fits-all approach and does not distinguish between the churches and/or religious organisations and the different types of non-profit organisations, while the USA has separate criteria used for religious organisations, as illustrated in section 4.4.2 of Chapter 4. The challenge with the South African approach is that not all organisations are the same and the church is certainly different from your ordinary PBO.

The intention of the exemption of non-profit organisations from paying tax was heavily motivated by the fact that these organisations stepped in to fill the gap to provide services that were supposed to be provided by the government. It was a manner of subsidy to lessen the burden of carrying out this public service. There ought to be distinguishing factors between an ordinary public benefit organisation offering social relief to the public and religious organisations.

In addition to the prohibition on the distribution of income and assets to the founders or key personnel, the USA provides for the imposition of excise taxes on transactions where there is an excess benefit extended to the insider of the tax exempt organisation. This serves as a deterrent for the formation of tax exempt public benefit organisations for the purpose of benefiting the founders. Case law in the USA has made strides in compiling guidelines to be used for the determination of what is reasonable remuneration, in an effort to enforce the private distribution ban through payment of excessive salaries and other employment benefits, something that the local laws in South Africa are yet to establish.

A commercial manner test is utilised to determine any income from unrelated commercial undertakings which would be subjected to income tax at corporate rates. This was done to limit the misuse and abuse of the tax exempt status by organisations which are actively pursuing commercial activities substantially unrelated to the principal exempt purpose. The South African tax laws allow for a basic exemption of the greater of 5 percent or R200 000 on the receipts and accruals of unrelated commercial income.

While there is a prohibition on political and lobbying activities by a tax exempt organisation, the IRS does permit certain limited and unsubstantial activities related to politics and lobbying, provided that such activities do not result in the influence of legislation and/or policies and does not result in interference in political campaigns to support or oppose any candidate. South African tax law has an absolute ban on political activities by tax exempt organisations.

The USA legislation, although imperfect, is more advanced in terms of implementation of the tax exemption and the monitoring of the qualification criteria for organisations. Regulations under Section 4958 ensure that there is recourse for the IRS in instances where there are excess benefit transactions, something that is absent in the South African legislation.

From the comparison between the American tax laws and South African tax laws as pertaining to the exemption of PBO from tax, it is clear that although strides have been made to align the South African law and practice to best international standards, there is still a lot of room to improve if we are to ensure that the tax exemption benefits are used for the eligible purposes. Table 4.1 below depicts the legislative similarities and differences between SA and the USA, as compiled by the researcher.

Table 4.1 – Tax legislative similarities and differences between SA and USA.

	South Africa	United States of America
Separation of church and state	Right of freedom to enjoy and exercise religion is guaranteed under the Bill of Rights in the SA Constitution (1996). Although an official clause for the separation of the state and religion is not explicit in the SA Constitution, the absence of any indication of state interference in religious freedom affairs confirms that the separation does exist (Section 4.3.1).	The First Amendment's free exercise clause protects religious freedom, association and practice thereof and the Establishment Clause advocates for the wall of separation between the state and church which ensures government neutrality between religion and non-religion (Section 4.4.1).
Definition of church/religious organisation	South African law does not define a church or a religious organisation. Any organisation purporting itself to be involved in the advancement or exercise of religion qualifies to apply for the tax exempt status (Section 4.3).	The federal tax system distinguishes a church from a religious organisation. There is no definition for a "church" however, there is criteria used to determine if an organisation is a church (applied on case-by-case basis). Furthermore, Section 501(c)(3) of the Internal Revenue Code (IRC) (1986) has conditions set for churches and religious organisations, which must be met before being granted a tax exempt status (Section 4.4.2).
Registration	The tax exempt status is not automatically assigned. Any organisation operating as a public benefit organisation (PBO) must first apply and be approved by the SARS Commissioner in order to access the tax exemption benefits granted to PBOs (Section 4.3).	Churches which meet the criteria of Section 501(c)(3) of the Internal Revenue Code (IRC) (1986) are automatically considered tax exempt and are not required to apply for the tax exempt status designation from the Internal Revenue Service (IRS) (Section 4.4.2).
Public benefit objective	Organisations whose formation is for the altruistic and/or philanthropic purposes for the benefit of the public, can be registered as a public benefit organisation (PBO) and be exempted from the payment of tax on certain income, in terms of Section 10(1)(cN) of the Income Tax Act (58 of 1962) (Section 4.3.2).	Churches are exempted from taxes under Section 501(c)(3) of the Internal Revenue Code (IRC) (1986) subject to certain conditions, *inter alia*, that the organisation must provide benefits to the society at large and activities undertaken should not only benefit those who operate the organisation (Section 4.4.4.1).
Exclusive operation for exempt purposes	The sole or principal objective should be the carrying on of one or more altruistic or philanthropic public benefit activity as listed in the Ninth Schedule to the Income Tax Act (58 of 1962). This activity should not be conducted to promote the economic interest of anyone other than by way of reasonable remuneration (See Section 4.3.2).	An organisation may qualify for exemption from federal tax under Section 501(c)(3) of the Internal Revenue Code (1986) if it is organised and operated solely for charitable purposes. In determining whether an organisation should be exempted from tax or not, "*organisation"* and "*operation"* tests are used, and both need to be satisfied to qualify (Section 4.4.3).

Business undertaking/ trading activities	Trading activities are permissible and fully exempt on condition that they are: a) an essential part of and are directly linked to the sole or principal object pursued by the public benefit organisation, b) being carried out in a fashion where substantially the whole of which is directed towards recovering costs and, c) does not result in an unfair competition to other tax paying entities (See Section 4.3).	A *commercial manner* test is used as a check mechanism to determine if an organisation is operating in manner akin to that of a for-profit company and therefore not qualifying for a tax exempt status. This test will then trigger further comprehensive investigation into the organisations' activities (Section 4.4.5).
Commercialisation and unrelated business income	The receipts and accruals falling outside the permissible trade exemption are taxable and will attract normal tax at 28 percent, subject to the deduction of the *basic exemption* which is calculated as the greater of 5 percent or R200 000 of the total receipts and accruals (Section 4.3.4).	Income derived from a trade or business activity that is substantially related to the exempt purpose is not subjected to tax. Any trade or business that is not substantially related to the exempt purpose will trigger *unrelated business income tax* (UBIT) levied at corporate rates on the income derived from each separate unrelated trade or business. There is no basic exemption deducted before tax is levied (Section 4.4.5).
Redistribution of income/ Private inurement prohibition	Distribution of income and assets to any person, other than in the course of undertaking activities is prohibited. Income and assets must be utilised solely towards the exempt purpose for which the public benefit organisation 9 is founded (Section 4.3.5).	The private inurement doctrine prohibitions the distribution of profits or the utilisation of the organisations' income or assets for the benefit of any individual who exercises control over it, be it direct or indirectly. Surplus funds retained in the organisation must be dedicated to the continuation of the tax exempt purposes (Section 4.4.4).
Private distribution of income	Public benefit activities may not be undertaken to promote the economic self-interest of anyone who exercises control over the public benefit organisation either directly or indirectly. Funds are to be expended for the exempt purpose (Section 4.3.5.1).	The prohibition on private inurement extends to individuals having a considerable degree of influence over the organisation such as trustees, officers or key employees while the private benefit prohibition is applied to any recipient of undue benefit. The violation of the private inurement is statutorily absolute while an incidental amount of private benefit will not generally imperil the tax exempt status of the organisation (Section 4.4.4.1).

Reasonable compensation	Payment of excessive remuneration to any employees, officials, members or any other person is prohibited. Remuneration must be aligned to sector standards and in line with the services offered. The payment of the remuneration should not be used to benefit any person economically in a manner that is not aligned to the objectives of the organisation. There is however no remuneration policies and standards available to benchmark remuneration in the religious sector (Section 4.3.5.2).	The courts have developed guidelines with factors to be considered when determining whether remuneration is reasonable or not. The IRS will classify any amount deemed to exceed reasonable remuneration as a dividend payment, which is not allowed as a deduction from taxable income (Section 4.4.2).
Political and lobbying activities	Section 30(3)(h) of the Income Tax Act (58 of 1962) prohibits any public benefit organisation from utilising its resources in support, advancing or opposing of any political party whether directly or indirectly (Section 4.3.6).	An organisation may not have a substantial part of its activities devoted to carrying out propaganda or making any attempts to influence legislation. The organisation may also not participate in or interfere in political campaigns in support or in opposition of any candidate running for public office. The substantiality of activities is determined by the amount of time spent on political activity. An expenditure test is also used where up to 20 percent of gross expenditure is permissible to be utilised for direct lobbying while up 5 percent of gross expenditure is permissible for grass root lobbying activities (Section 4.4.6).
Sanctions for non-compliance	Failure to comply with Section 10(1)(cN) and Section 30 of the Income Tax Act (58 of 1962) may result in SARS withdrawing the tax exempt status from the public benefit organisation. The SARS Commissioner must give a notice of intention to withdraw tax exempt status first and if corrective steps are not taken within the stipulated timelines, the status will be withdrawn. Persons tasked with fiduciary duties face a fine or imprisonment of up to 24 months for intentional failure to comply with any provision of Section 30 (Section 4.3.7).	Where the value of the benefit provided by the organisation exceeds the value of what the person provides to the organisation in return, an excess benefit transaction will be triggered, attracting the imposition of excise tax between 25 percent and 200 percent (Section 4.4.7).

The next chapter will discuss the misuse of the PBO tax exemptions by the religious organisations in South Africa

CHAPTER 5: MISUSE OF THE PBO TAX EXEMPTION IN SOUTH AFRICA AND OTHER PROBLEMS IDENTIFIED IN THE STUDY.

5.1. Introduction

The previous chapter was a comparison of the PBO tax exemption administration between South Africa and the USA, looking at the regulatory frameworks governing the exemption. The focus was on the qualification criteria used to determine the eligibility for tax exemption, for churches and religious organisations in particular. This chapter discusses the possibility of the misuse of the tax exemption by religious organisations in South Africa and will also focus on the financial abuses and governance as well as the financial disclosure in this sector as per the secondary objective in Chapter 1, section 1.3.2.

The prosperity gospel has been exploding in popularity, influence, and prominence in South Africa and has stirred up controversy over the years (Appiadu, 2019:3; Niemandt, 2017:206; Pondani, 2019:ii ; van Wyk, 2019a). Since the dawn of democracy, preachers across African states have been flocking into townships, converting masses to this new gospel. Precise statistics are not obtainable; however, scholars agree that prosperity gospel followers could exceed those known to be in traditional churches (van Wyk, 2019a).

Hunt (2000:331) identified the influence of the prosperity gospel, locating its historical origins within the North American Christian-centred movements, within the Pentecostal faith. Hunt (2000:332) and Heuser (2015:21) noted that this type of gospel is placed more specifically within the USA-style religion with an inclination towards materialism. Heuser (2015:16) asserts that it is *"transformative in nature, adapting to contexts, and travelling through history…",* and has a sense of spiritual development placing emphasis on material prosperity in most instances.

The scandals involving abuse of human rights and religious freedoms, fraudulent financial matters, embezzlement of funds and lack of accountability in the church have been reported by the media over the years (EWN Reporter 2020; Goba, 2015; Makhubu, 2016; Mashaba 2015; Mokoena, 2015; Mothombeni, 2017; News24, 2018a). The increased interest in the activities of the church bears evidence to the concerns around the financial management of church finances.

The community of Ngcobo in the Eastern Cape witnessed a tragic shooting incident in February 2018, where a shoot-out occurred between the police and criminals housed in the Seven Angels Ministry, a church previously reported to CRL Rights Commission (2017) for the abuse and violations of human rights against children (Evans, 2018). Dube (2019:1) states that the killings, as seen at the Seven Angels Ministry, suggest that while religion has long been viewed as a vehicle promoting good citizenship, education, character building, and peaceful conflict resolution, it has also become a threat in South Africa by being a "mafiarised space" with the potential to cause social unrest and crime.

Resulting from these increased reports from the media, the CRL Rights Commission (2017) held investigations into the commercialisation of religion and the abuse of people's religious beliefs, with one of the mandates being to investigate the financial activities of emerging churches to determine how they make their money, who collects it, what is done with it, and the governing principles that safeguard that money (News24, 2015b).

5.2. Abuse of religious freedoms

Dube *et al*. (2017:330) argue that the application of the right to freedom of religion, as protected by the SA Constitution (1996:7), has presented unforeseen trajectories such as abuse, commercialisation of religion, and human rights violations which threaten the beauty of religion in a society. Dube (2020:1,4 & 5) notes that although South Africa has entered exciting and interesting times in the prophetic space with innovations emerging unimagined by the orthodox religious space, it has also seen troubling times in recent years, with the rise of prophetic movements marred by competition that has incited wars based on nationality, popularity, and jealousy. Dube *et al.* (2017:331) cite that all religions have inherent rituals that can pose a threat to society if allowed, such as terrorism, patriarchal tendencies, violence, and various abuses of human rights. According to Lunn (2009:939) when religion is not regulated, it can become a drawback to economic progress and be irrelevant in the modern world.

Dube *et al*. (2017:337) identify the commercialisation of religion as one of the emerging trajectories of religion in contemporary South Africa. Commercialisation of religion is described as using religion to sell hope and to make a profit, and with the New Age prophets often characterised by the accumulation of wealth that they obtain from members of the church (Dube *et al*., 2017:337).

Taking this definition of commercialisation of religion into account and the loosely defined principle of freedom of religion, religious leaders justify their exploitation and the theft of money as obedience to God (Dube *et al*., 2017:337).

Dube *et al.* (2017:334-335,337) narrate the story of Jim Jones, the founder of the People's Temple, who indoctrinated his followers to give up on their previous lives and turn over all their material possessions to him, in order to become like God. He did so by isolating them from the world, employing physical and psychological coercion as part of a mental conditioning strategy. By giving his followers hope, making them believe that change is possible, it became easy for them to entrust their wealth to him. Dube *et al.* (2017:334-335) point out that similar practices of indoctrination are evident in some churches today and this leads to the impression that the church is a profit-making scheme operating under the guise of religion. Epondo (2015) believes that these new ministries operate like insurance companies with superior spiritual powers, taking advantage of the followers' hopes and fears, in exchange for generous tithes. He further argues that these prophets are also driven by the desire for a better life for themselves and will continue with their exploitation of people's faith and fears. By failing to deal with the commercialisation of religion, the government has placed people at the mercy of individuals who use religion to extort money from them (Dube *et al*., 2017:338).

5.3. Registration compliance

Sections 12, 17 and 18 of the NPO Act (71 of 1997) provides clarity on the registration requirements of NPOs with the DSD as well as the accounting records and reports expected from these organisations once registered, while Section 30(3) stipulates the conditions on which the SARS Commissioner will approve a PBO as a tax exempt organisation. It is to be noted that the tax exempt status is not automatically bestowed, and organisations must apply. An organisation will remain a tax-paying entity in the absence of this application and approval thereof.

The only reliable record for any meaningful analysis on the NPO sector is the register by the DSD (Ngandu & Motala, 2019:12) and as at May 2020, there were 228 822 registered NPOs on the DSD national register, of which 133 724 (58.44 percent) were non-compliant with the relevant legislation (DSD, 2018b; DSD, 2020). However as reported by the CRL Rights Commission (2017:29), the number of religious affiliations in the country is unknown as many operate without being registered, a fact supported by van Wyk (2019b).

The fact that there are an undocumented number of religious organisations operating without scrutiny may be an indication that in practice, the NPO Directorate has limited or no capacity to implement the law. Ngandu and Motala (2019:12) postulates that the DSD is unable to fulfil its role of registering NPOs. The effect of this incapacity is not only limited to financial mismanagement, but loss of lives as seen in Life Esidimeni where mentally ill patients died after being placed in newly registered NGOs and which were not “for purpose” (Makgoba, 2017).

As alluded to in section 3.4 of Chapter 3, registration of PBOs is voluntary and free of charge and once registered an organisation will be issued with a certificate which remains valid until the registration is cancelled; the organisation deregisters voluntarily, is wound up or dissolved. The researcher postulates that what may be problematic is the wording of the NPO Act (71 of 1997) which suggests that the laws therein apply to organisations which intend to register and those already registered with the DSD. Because registration with the DSD is voluntary, there is no obligation on religious organisations to register, which can lead to the assumption that this legislation is not enforceable unless the organisation is registered with the DSD.

What becomes a pertinent question, is whether the NPO Directorate has enough will and capacity to ensure adherence to the legislation and is the legislation sufficient to ensure that all organisations are registered, and whether or not those that are on the register, are compliant to the requirements of certification. Indicative of this challenge is for example, in the briefing session of the NDA and the DSD held on 22 August 2018, the DSD lamented the fact that the increased registration of NPOs was straining the human capacity of the department, indicating that “*there was only so much employees could do”* as well as the fact that it was reported during the meeting of the Standing Committee on Social Development, held on 26 May 2020, that the Western Cape had 23 492 registered NPOs, of which 60.36 percent were non-compliant with the relevant legislation. The staff at the provincial department was said to be between fifty-five and fifty-seven comprising of monitoring officers, specialised social workers, and only four financial inspectors (DSD, 2018b; DSD, 2020).

5.4. Financial scandals of the church

As pointed out in section 1.1 of Chapter 1, the financial matters of churches have been brought into the public focus after the media coverage of human rights abuses and the findings of the investigation undertaken by the CRL Rights Commission (2017). This

followed years of media reports regarding the human rights abuses, mismanagement, and embezzlement of church funds. The media has been the main source of highlighting the scandals affecting religious organisations in South Africa and there isn't sufficient research done on these issues outside the theological study perspective.

The following news headlines suggest that there is a considerable problem in the financial affairs and governance of the church:

- *Prophet Bushiri and wife granted bail of R200 000 each pertaining to allegations of fraud, theft and money laundering amounting to over R100 million against leader of Enlightened Christian Gathering (EWN Reporter, 2020).*
- *The CRL Rights Commission hears testimony of how Bishop Stephen Zondo, the leader of the Rivers of Living Waters Ministry, has financially exploited his congregants to fund his lavish lifestyle by charging R10 000 for one-on-one sessions and a minimum of R5 000 for gala dinners , this over and above tithes and "sin" offerings (Njilo, 2020).*
- *At the centre of the legal battle between leaders of International Pentecost Holiness Church (IPHC) is claims that at least R110-million has been siphoned from the church's bank account since founder, Modise died (Mothombeni, 2017).*
- *South African born and trained pastors probed by the British Charity Commission for the missing R6 million at Rhema Church London (Hosken, 2017).*
- *Prophet Bushiri of ECG reported to be charging congregants R5 000 to have one-on-one sessions with him (Mashaba, 2015).*
- *Prophet Paseka "Mboro" Motsoeneng fails to account to the CRL Commission when asked about where the money donated by church members was being kept safe after he had disclosed to the Commission that the church did not have a bank account (Mabona, 2015).*
- *The Evangelical Lutheran Church of Southern Africa general assembly (the church's highest statutory body) investigation into the missing R40 million which was divested from an insurance company (Goba, 2015).*
- *The Tshwane branch of the Evangelical Presbyterian Church accuses the Executive Committee of its mother body, the Evangelical Presbyterian Church*

in SA, of failing to comply with its obligations to maintain proper internal control of its finances resulting in financial disarray (Venter, 2012).

- *Internal audit findings reveal more than R1 million missing from the coffers of the Methodist Church of Southern Africa, allegedly stolen by church officials (Kotlolo, 2012).*
- *The Anglican Church in the Southern Cape rocked by financial scandal after millions of rands donated by worshippers, is embezzled from the church (Eggington, 2010).*
- *A pastor at loggerheads after investing R500 000 in a bogus investment scheme using church funds (Moselakgomo, 2008).*

The CRL Rights Commission (2017) held hearings between November 2015 and March 2016 to investigate the commercialisation of religion and the abuse of people's belief systems in South Africa. Although precise data for the number of religious organisations operating in South Africa is unavailable, the CRL Rights Commission noted that there are many (CRL Rights Commission, 2017:17; van Wyk, 2019a). The CRL Rights Commission selected a sample of over 85 leaders from large to small organisations, from mainline or traditional churches to charismatic, Pentecostal, Islamic, Bahai Faith, Judaism, Hinduism, non-Christian religions, African Independent churches, and African traditional religion. Those summoned to appear before the CRL Rights Commission were requested to make presentations on *inter alia:*

- history of the organisation and training requirements of the leaders.
- governance structures and fundraising strategies.
- soliciting of payments for conducting funerals, weddings and offering prayers.
- how money in the organisation was utilised and if it was transferred outside the country.
- their understanding of the commercialisation and abuse of people's belief systems. (CRL Rights Commission 2017:16).

The CRL Rights Commission reported that the challenges faced included the refusal by certain leaders to submit the statutory documents such as financial statements, AGM minutes, constitution, signatories to the bank accounts, organograms of the organisation etc. as well as refusal by other leaders to answer questions posed by the panel. The panel was also faced with threats from some leaders of the religious organisations (CRL

Rights Commission, 2017:17). The findings of the CRL Rights Commission (2017) were that, *inter alia,* there is:

(a) *prima facie* evidence suggesting the existence of commercialisation of religion where congregants were requested to part with money in exchange for blessings and prayers, selling of merchandise such as holy oil/water and t-shirts, clothes, Vaseline sold for good luck, payment to access the spiritual leader, and the use of speed points for swiping money in favour of the church during ceremonies.

(b) non-compliance with the registration with the DSD and SARS tax laws.

(c) lack of good governance and oversight structures. (CRL Rights Commission, 2017:30-33).

The internal control systems in churches might be inadequate and governing bodies could fall short of providing proper financial monitoring and supervision, which would make churches prime targets for embezzlement (Duncan, Flesher & Stocks, 1999:143; Musau, 2017:13). Greenlee, Fischer, Gordon and Keating (2007:677) note that although there have been reports published by the media, there is little research on the real extent of fraud in the religious sector, as most goes unnoticed and unreported and in some instances the church leadership chooses not to involve authorities by reporting the culprits who syphon money from the church coffers but rather opts to deal with the matter internally in a “spiritual manner” (Ahiabor & Mensah, 2013:115; Eggington, 2010). This is confirmed by Fleckenstein and Bowes (2000) according to whom, the church usually overlooks internal control policies opting to apply qualities such as mercy and trust. Laughlin, in a study conducted by Duncan *et al.,* (1999:146) revealed that although pastors understand internal control principles, they viewed them as secular and inconsequential. Internal controls are also misunderstood to exist solely for the goal of discovering and preventing fraud and this has often deterred church leaders and religious organisations from implementing solid control measures for fear of seeming untrusting (Ahiabor & Mensah, 2013:115).

The financial scandals mentioned above are an indication of the fact that the church is not immune to misappropriation and mismanagement of finances (Greenlee *et al.,* 2007:680; Tanui *et al.,* 2016:31). The lack of accountability and transparency in finances as reported in the media and as displayed in the hearings and recorded in the findings of the CRL Rights Commission (2017), elicit questions regarding whether the religious

sector should continue to enjoy the benefits of tax exemption. There may be leaders within the religious sector who may defend these scandals as a few “bad apples”, however there are sufficient occurrences to raise questions regarding the adequacy, efficiency, appropriateness, and the continuation of the self-regulation principle in this sector.

5.5. Financial management

Financial scandals as mentioned in section 5.4 shine the light on the corruption, misappropriation, and mismanagement of church funds as well as governance matters, all of which challenge the credibility of religious organisations. Appiadu (2019:3) notes that the interest of civil society and the authorities about the activities of churches, more so the charismatic churches, demonstrates the concerns regarding financial management of church finances, due to the fact that the conduct of the church around finances has far more influence on the broader society, not only the congregants and the said churches.

Masters, Tyler and Copley (2018:3) explain financial management as the planning, monitoring, and controlling of an organisation’s funds and not just the obtaining and recording of finances in order to achieve objectives. There is available research that shows that managers in the for-profit sector use their own discernment in financial reporting and arranging transactions to alter financial reports as a way to either mislead stakeholders about the true financial status of the company or to influence contractual outcomes that depended on the financial position as reported. Hofmann and McSwain (2013:62) indicate that research also shows the same to hold true for the non-profit sector, where there is both motive and opportunity to misreport financial information for the same sinister reasons used by the for-profit organisations (Garven, Hofmann & McSwain, 2016:401; Hofmann & McSwain, 2013:62).

Non-profit as well religious organisations are susceptible to financial fraud because the members and authorities do not closely monitor their financial affairs and more so those that lack controls and systems in place to guard against this are the most vulnerable (Greenlee *et al.*, 2007:690; Rockson, 2019:21; Taylor, 1982:1204). Musau (2017:15) regards finances as an important function of any organisation irrespective of size because to execute activities successfully requires financial contributions. McMenamin (2002) postulates that ineffective and weak financial management can make an organisation collapse.

Religious organisations need to be accountable to the congregants and donors who support their cause with financial resources, and without proper systems in place, it will be impractical to keep track of the expenditures, maintain and compile financial reports to account for the utilisation of funds to the regulatory bodies as required by the NPO Act (71 of 1997) and the Income Tax Act (58 of 1962). Complete financial planning, coordination, and putting proper internal control measures in place, can address these issues.

5.6. Accounting records and annual reporting

NPOs have stewardship responsibilities to various stakeholders such as the general public, donors, shareholders, grant providers, and the government, therefore it becomes crucial that the NPOs' annual reports have credibility. Annual reports are a legal document providing a degree of legitimacy that the other media cannot provide, and it has become a key instrument by which management fulfils its reporting obligations (Dhanani & Connolly, 2012:1141). Annual reports that are of a high-quality, assist organisations in fulfilling accountability for good stewardship, and following the generally accepted accounting standards helps to provide high-quality annual reports (Zainon, Hashim, Yahaya & Atan, 2013:183). The annual and financial reports take the centre stage as a mass communication tool within the public discourse structure, used widely by organisations for accountability between the NPO and its stakeholders, thus allowing for a complete and proper understanding of the NPO's activities, financial transactions, successes, and failures as well as allowing for the monitoring of such (Dhanani & Connolly, 2012:1140-1141; Zainon *et al.,* 2013:183-184). Financial reports also provide critical data for planning, budgeting, and controlling church finances (Ahiabor & Mensah, 2013:117).

The NPO Act (71 of 1997) requires the organisation to keep accounting records and draw up financial statements in accordance with the standards of generally accepted accounting practice (hereafter GAAP), to retain the registration certificate as well as submit narrative financial reports and the accounting officer's report within certain timeframes. Although the GAAP, referred to in the NPO Act (71 of 1997), is not defined, it is commonly understood to mean that financial statements compiled must be aligned and acceptable to a particular industry or sector. NPOs would generally prepare financial statements using one of these following standards (SAIBA, 2015:11):

- International Financial Reporting Standards (IFRS).
- International Financial Reporting Standards for Small and Medium Enterprises (IFRS for SMEs).
- Modified cash basis of accounting or other basis suitable to the activities and nature of the NPO.

Consideration when selecting the reporting method should be given to legislative requirements, donors or grant specifications, and the nature and scope of activities undertaken by the NPO. The accounting officer's report submitted to the NPO Directorate must state if the NPO's:

- financial statements are consistent with its accounting records;
- accounting policies are suitable to the organisation and have been applied appropriately in the preparation of financial statements; and
- has complied with the requirements of the NPO Act (71 of 1997) and its own constitution concerning financial matters.

It is also the duty of the accounting officer to submit a written report to the NPO Directorate detailing any failure by the organisation to comply with the NPO Act (71 of 1997) or its constitution within a month of becoming aware of such non-compliance. The responsibility to report to the Directorate of the NPO supersedes the confidentiality obligation owed by the accounting officer to the organisation (SAIBA, 2015:12).

In a Gauteng pilot study on the commercialisation of religion conducted by the Unisa Bureau of Market Research (hereafter BMR) as commissioned by the CRL Rights Commission, based on a sample of 905 participants from different institutions, it was found that those leading and managing religious institutions could not confirm that their organisations prepare and submit financial statements to the authorities as required and some acknowledged that they are not conversant with the legislation governing the establishment, regulation, and monitoring of religious institutions in South Africa. It was also noted that they were also not agreeable to being audited by a firm of external auditors (BMR, 2016:119).

During their investigation, the CRL Rights Commission (2017:19) also found serious organisational and administrative deficiencies, although not all were necessarily intentional. The deficiencies included failure to register as NPOs and failing to maintain financial records.

The reporting requirements for the PBO sector is set under Section 30(3)(e) of the Income Tax Act (58 of 1962) and reads as follows:

"Complies with such reporting as may be determined by the Commissioner"

This section is not explicit and may leave the organisation questioning what the reporting requirements are for SARS. This is further compounded by the fact that registering with the DSD is not a pre-requisite for the organisation to be granted tax exempt status by SARS. Without any interpretation note, this section also leaves the determination of reporting requirements to the discretion of the SARS Commissioner, and this may have the unintended consequences of inconsistent application

In the UK, charities including faith-based charities, are registered with, and regulated by either the Charity Commission or the principal regulator. There is a duty on these organisations to be publicly accountable, prepare proper accounts, auditing, and annual reports, and upon written request, provide a copy of these to anyone within two months, at a reasonable fee to cover the costs of doing this (Charities Commission, 2013:4-7). This is absent from the South African regulations and therefore financial reports of churches are not readily available to the public as it is not a legal requirement. French (2018) relates the difficulty in obtaining financial statements and related reports although it was indicated that these were available on the organisations' websites. The accessibility of annual reports and audited accounting records to the public in South Africa is an important issue as it will remove the veil under which religious organisations have been operating when it comes to finances and may allow for greater transparency and accountability.

The information in Table 5.1 is a compilation of what was extracted from the financial statements of five (5) churches sourced from the internet. It should be noted that recent financial statements were not readily available on the internet, therefore the latest financial statements uploaded on the internet were used. This being a mini-dissertation, and the statements only for illustration of the problem only a few financial statements as obtained from the internet, were used to conduct this research.

A brief description of the churches whose financial statements could be found follows below:

- Church A

  Is a member of a family of churches located in Stellenbosch, whose aim is to strive doctrinally and in practice to be evangelical, reformed and conservative.

- Church B

  This church is branch of the dioceses of churches and is located in Bryanston, Johannesburg.

- Church C

  This church was established in September 1999 after the merger of two churches which were established in 1897 and 1923 respectively, and has congregations in South Africa, Zambia, and Zimbabwe and is establishing work in the Democratic Republic of Congo.

- Church D

  This is an evangelical church based in Fish Hoek, Cape Town.

- Church E

  Is a Johannesburg branch of a mother church established in 1870, which comprises of 28 dioceses in six sovereign nations being Angola, Lesotho, Swaziland, Mozambique, Namibia, and South Africa as well as on the island of St. Helena. The mother church has a total membership of approximately three million people. It could not be established how many members form part of each branch. The financial statements of church E are representative of this one branch only and not the entire mother church.

As per the extractions, only Church E accounted for taxation on unrelated commercial activities. What is peculiar is that they also deducted interest expenditure of over R4 million, incurred from short term investments. The rest of the churches did not account for any taxation on their financial statements. This demonstrates that the concept of exemption may be misunderstood to mean all activities undertaken are exempt from tax if one is operating as a church.

It is also worthy to note that employment expenses (salaries and wages) range between 22.3 percent and 86.09 percent of the total receipts and accruals. The matter of compensation and the promotion of economic self-interest is discussed in detail in Chapter 4, sections 4.3.5.1 and 4.4.4.2 and Chapter 5, section 5.8.

It is of interest to note that the external auditors of Church C expressed a qualified opinion on the basis that it could not be concluded that the donations received by the organisation were accurately and completely recorded in the correct period. The exact nature of assessment fees is unknown and there is no explanatory note for it. Church C also have investments in unit trusts; however, it cannot be determined that the church is actively investing in these. The statistics on the church membership as well as the number of employees of the above churches could not be established as the information is not available on the public platform.

Table 5.1- Extracts from church financial statement

EXCERPTS FROM THE STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED:																
Church A				**Church B**				**Church C**				**Church D**			**Church E**		
28 February 2018				**31 December 2018**				**30 June 2018**				**31 December 2017**			**31 December 2016**		
Income			% of income	**Income**			% of income				% of income	**Income**		% of income	**Income**		% of income
Student Ministry	R	121 552		***Parish Affairs***				**Revenue**				Tithes and offerings	R 3 437 481		Parochial Contributions	R 9 362 639	
Children's Ministry	R	15 847		DG Tithes ,Dues etc.	R	3 994 939		Assessment fees	R	12 671 047		Thanks offerings	R 50 000		Organisations	R 1 125 500	
Youth Ministry	R	2 600		Collections	R	646 532		Resources	R	312 585	2.4%	Interest	R 12 620	0.3%	***Total***	***R 10 488 139***	
Groups, Seminars & conferences	R	19 334	0.86%	Donations, thanksgiving & bequests	R	176 973		Rental income	R	3 600	0.03%	Other income	R 492 151	12.3%	***Financing Activities***	***R 5 565 329***	
Parking	R	75 935		Special Efforts	R	45 000			**R**	**12 987 232**		**Total Income**	**R 3 992 252**		Interest received- Internal	R 3 175 393	19.8%
Crete (Rent received)	R	44 486	1.97%	***Financing income***				Operating expenses	R	12 823 263		**Expenditure**			Interest received- External	R 1 538 016	9.6%
	R	**279 754**		Interest received (DFB)	R	21 996	0.4%	Operating surplus	**R**	**163 969**		**Income related**			Interest Sharing- Internal	R 681 032	4.2%
Shared services	**R**	**1 981 314**		Interest received (External)	R	30 099	0.6%	Investment revenue	R	119 377	0.9%	REACH SA Levy	R 343 747		Income Tax from sharing	R 170 889	1.1%
Book table	R	1 755	0.08%	Profit on sale of fixed assets	**R**	-		**Surplus for the year**	**R**	**283 346**		Missions	R 239 800		**Total Income**	**R 16 076 510**	
Car rental	R	1 800	0.08%	**Gross Income**	**R**	**4 915 541**							**R 583 547**				
Charity sales	R	13 379										**Non-income related**			**Expenditure**		
Church and hall rentals	R	29 860	1.32%	**Expenses**				**Employee costs**				Ministries	R 323 300		Bishop's office	R 1 560 624	9.7%
Interest received	R	82 498	3.65%	Diocesan Contribution	R	956 400		Central offcie	R	3 038 239		Employment	R 2 345 402	58.7%	Diocesan Administration office	R 2 965 598	18.4%
Men's ministry	R	700		Tithing from income	R	45 000		Other offices	R	1 306 355		**Total Expenditure**	**R 3 400 576**		General diocesan expenses	R 2 433 554	15.1%
Specified giving	R	257 974		Staff Salaries (Laity)	R	1 094 494	22.3%		**R**	**4 344 594**	33.5%				Interest paid on short term investments	R 4 014 964	25.7%
Tithes and offerings	R	1 483 295										**Net surplus/(Deficit)**	**R 8 129**		Taxation on commercial income	R 175 909	1.1%
Tithes and offerings-Student Ministry	R	110 053		**Surplus /(Deficit) before Tax**	**R**	**579 070**									**Total expenditure**	**R 15 621 326**	
Total revenue	**R**	**2 261 068**															
Shared services expenses															Net surplus of Diocesan Finance Board	R 455 184	
Books. Dvd's and materials																	
Motor vehicle															***Johannesburg Diocese Trustees***		
Salaries and Wages	R	1 946 501	86.09%												Income from Trust Assets	R 847 209	
Snacks, beverages and catering	R	59 869													Expenditure relating to trust asse	R 1 120 221	
															Net Surplus/(Deficit) of trustees	**R -273 013**	
Net shortfall after taxati	**R**	**658 081**															
															Total Surplus/(Deficit) for the ye	**R 182 171**	
**** Possible calculated unrelated business income***																	
Unrelated Business income	**R**	**179 733**	7.95%	**Unrelated Business income**	**R**	**52 095**	1.1%	-		-	-	**Unrelated Business income**	**R 504 771**	12.6%	**Unrelated Business income**	**R 5 565 329**	34.6%

5.7. Commercial activities

As indicated in section 4.3.3 of Chapter 4, receipts and accruals from a non-trading activity of a PBO are fully exempt other than receipts and accruals from a business enterprise or trading activity conducted outside the permissible restrictions, subject to the basic exemption. The commercial activity so undertaken must be an essential part of and be directly related to the PBA for which the organisation is established.

There are multiple revenue streams over and above tithes, with churches being custodians and proprietors of various economic ventures and being run like a commercial business having public relations, marketing, advertising and sales departments (Appiadu, 2019:2; Rockson, 2019:2). Morlin-Yron (2016) confirms the appropriateness of comparing the special events such as annual conferences of some churches to the annual US Super Bowl in terms of attendance and funds raised during the events.

The revenue streams of many churches, especially the charismatic Christian churches, are varied and include bookshops selling Christian literature, CDs/DVDs, selling of funeral policies, stickers, T-shirts, and other merchandise (Appiadu, 2019:2). Agazue (2016:4) and Van der Watt (2012:47) also noted that the pastor's face is often printed on items of clothing, which members believe that the said item will perform miracles, such as protecting them from road collisions, armed robbery attacks and other social ills. Masenya and Masenya (2018:637) also attest to this in that the pastor prays for such ordinary items with the promise of blessing them in their daily endeavours. The selling of merchandise by churches may present an unfair advantage to other retailers of such goods as the church would intertwine the income from tithes and offerings with the sale of such goods and receive the benefit of the income not being taxed.

Accurate statistics on the number of churches/religious organisations operating in South Africa as well as the percentage of those involved in commercial activities are not obtainable . Below are some examples that show the commercial activities undertaken by some religious organisations:

- A mining magnate partnered with Zion Christian Church (hereafter ZCC), a church with over 12 million members in South Africa, to launch the first black owned bank called TymeBank, which will see the bank being the financial partner of choice for the church members. The partnership was launched at the church’s headquarters in Moria, Limpopo, and is said to be a strategy to

increase the bank's clients and enable it to compete with established banks. The church members were offered to take up a Zion City Moria (ZCM) membership card which would serve as both a membership card and a bank card. The benefits offered to those who would join the bank included zero-rated data for SmartApp, internet banking and extra Pick 'n Pay Smart Shopper rewards (Sibanyoni, 2020; Thompson, 2020).

- In 2017, Vodacom and the Nazareth Baptist Church known as Shembe, announced that they had entered into an agreement that would see the church distributing Vodacom's products and services to its over 6 million members. Although the value of the deal was not disclosed, it was said to be mutually beneficial to both parties (Mngadi, 2017).
- In a 2008 interview, Apostle Simon Mokoena, informed the reporter that the church he founded, Tyrannus Apostolic Church, employs church members at the restaurants it owns in Phuthaditjhaba in the Free State and owns a funeral scheme and vehicles. The church also owns a factory where the church uniform is produced and counts a souvenir shop and the selling of CDs and DVDs as part of its income generating vehicles (Sowetanlive, 2008; Van der Watt, 2012:46-47). Mahlangu (2012) reports that in addition to producing various goods in the factory it owns, the church, which is the fastest growing church boasting over 1 million members across a thousand branches in South Africa (Van der Watt, 2012:46), also rebrands various products from washing powder, fabric softener, bottled water to toilet paper - all branded "Apostle".

Some churches have bookshops at their premises offering religious materials for sale to the congregants in direct competition to other tax-paying bookshops (CFC, 2020).

The links below are examples of bookshops operated by churches:

- https://crcbookshop.co.za/index.php/product-category/book/
- https://rhemabookstore.co.za/
- https://www.christianfamilychurch.co.za/the-cfc-mall

Figure 5.1 below was taken off the website of a church in Johannesburg and it describes that there is a mall inside the church premises with a restaurant, fast food court, sweet shop, boutique, spa, and a bookstore for the convenience of the worshippers, open even on weekdays.

Figure 5.1 - CFC Mall. Source: CFC, 2020.

The CFC Mall

We know from experience that people just love to fellowship and for this reason, we have a beautiful Mall area where members and visitors can get together both before and after services. The Mall boasts our restaurant where you can enjoy a quality breakfast, lunch or supper and there is also a food court with three outlets for fast-food and coffee that you can enjoy either on the premises or to take-way.
We also have a sweet shop to accommodate for kiddie cravings!

Be sure to stop by our I Am Worthy Boutique and I Am Worthy Spa, where part of the proceeds go to the plight of orphans and abused women.

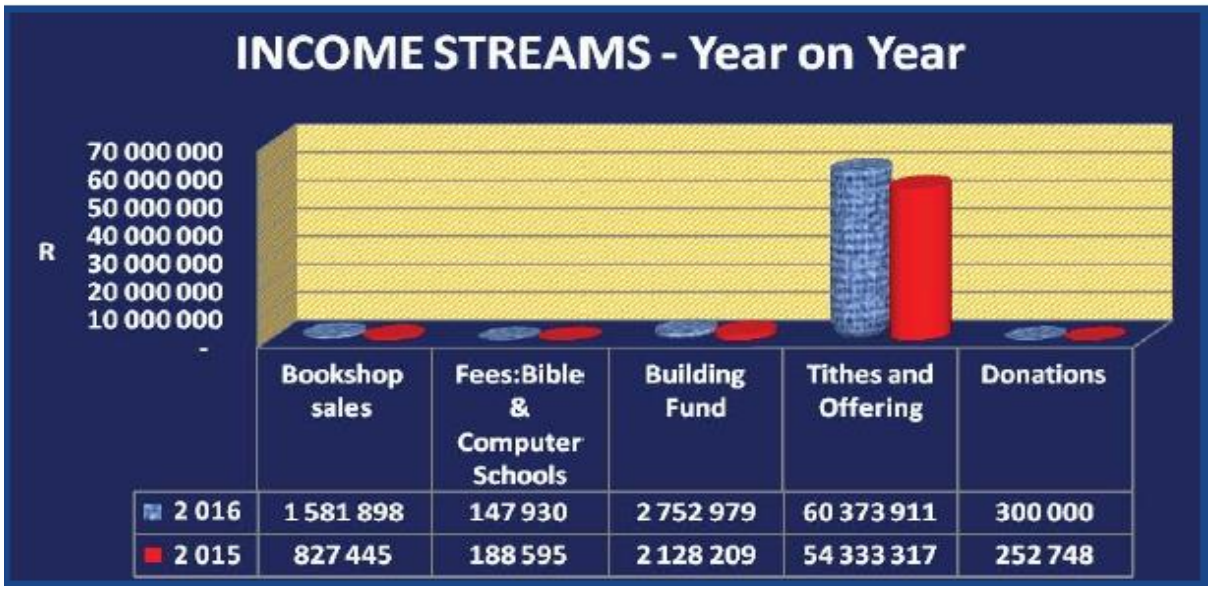
For your convenience, there is also a Bookstore.

There are television screens throughout the Mall where a variety of sports programs can be viewed both on weekends and during the week and any major sporting events are aired for your convenience.

Feel free to invite your friends and family to join you for a beautiful experience.

Figure 5.2 below depicts the income generation stream of Grace Bible Church, based in Soweto, taken from their 2016 annual report. Bookshop sales is the third highest contributor to income generated accounting for R 1 581 898 in 2016 (close to 3 percent) (Grace Bible Church, 2016:45). This report does not contain information that would enable one to determine factors such as profit margin on the sale of books.

Figure 5.2 - Income streams of Grace Bible Church 2015/2016. Source: Grace Bible Church (2016:45).



	Bookshop sales	Fees:Bible & Computer Schools	Building Fund	Tithes and Offering	Donations
2 016	1 581 898	147 930	2 752 979	60 373 911	300 000
2 015	827 445	188 595	2 128 209	54 333 317	252 748

The Citizen (2017) reported that Grace Bible Church gave a quotation of R89 000 to the family of veteran actor Joe Mafela, for hosting the actor's memorial service. The church leadership confirmed that the church facilities are made available to the general public

and the quoted price for usage is based on the request made (IOL, 2017). The church also hosted the memorial service of Bafana Bafana[8] soccer legend, John “Shoes” Moshoeu on 24 April 2015 (ENCA, 2015). However, in the same reporting period ending February 2016, there is no category for income derived from venue hire as shown on Figure 5.2. There is also no mention of tax in the entire report thus showing that unrelated business income is not separately accounted for and the taxation thereon, is not calculated.

The Rhema Bible Church website (n.d) lists that there are many venues available for hire to host events including the 7 250-seater main auditorium, the 1 500-seater Rhema Action Centre and the chapel. The memorial services of departed celebrities Simba Mhere of Top Billing and Akhumzi Jezile as well as the funeral of singer Robbie Malinga and sports analyst, David Kekana were held at Rhema Bible Church (ENCA, 2018; News24, 2015c; News24, 2018b; Strydom, 2019). These raise concerns that the income generated from entrepreneurial activities are not separated from the tithes and offerings donated by the church members and properly accounted for when annual reports and financial statements are compiled. This is not taking away that funeral services form part of church services offered to ordinary to church members, however, the charges are not normally exorbitant.

Churches, like other non-profits, have been forced to take steps to increase their economic viability due to financial constraints they have experienced (Kitawi, 2015:1026). However, from these examples, it can be seen that the trading by some churches can range from a small scale trade to fully-fledged business deals that should be competing in the markets. Tax- paying entities would be taxed on the taxable income while the religious organisations have the benefit of a basic exemption on trading activities before tax can be calculated, and that is if their trading activities are properly accounted and declared separately from tithes and offerings.

5.8. Promotion of economic self-interest

Section 30(1)(b)(ii) of the Income Tax Act (58 of 1962) prohibits religious organisations, as part of PBOs, from operating in a manner that seeks to promote the economic self-interest of any employee or fiduciary of the organisation, either directly or indirectly, except for what is considered reasonable remuneration to that employee or fiduciary.

[8] South African national soccer team

Paragraph (3)(d) of Section 30 of the Income Tax Act (58 of 1962) also forbids the payment of undue remuneration, suggesting that the remuneration paid should be consistent with industry standards and aligned to the services offered by the person being compensated and consistent with the organisation's objectives. As indicated in section 4.3.5.1 of Chapter 4, there is a lack of available material in South Africa to enable research into what could be considered as reasonable compensation in the religious sector, unlike in the USA where there are guidelines developed to determine what is considered to be reasonable compensation (discussed in section 4.4.4.2).

The greater part of the revenue received by churches generally, are from tithes and offerings (Tanui *et al*., 2016:41). The church's mission as a non-profit organisation is not to issue shares or to maximise profits as is the case for corporates, which are answerable to shareholders and boards. Church leaders are instead accountable to the members of the congregations who provide the capital for the operation of the church (Ahiabor & Mensah, 2013:116).

Internal control and governance mechanisms in religious organisations are lacking at times, and the church leadership may dismiss these as worldly and thus insignificant. In instances where there are such structures in place, the pastors may be heading the boards or councils and involved in the nominating and approving of those to serve on the board (Grace Bible Church, 2016:41-43; Musau, 2017:13-14). There are a range of rules that govern operations and processes for corporates, whereas there are fewer external institutions to oversee NPO accountability, and many of the sector's organisations are self-regulatory (Appiadu, 2019:44; Burger *et al.*, 2018:10).

The prosperity gospel in Africa is rapidly rising, outgrowing all other conventional brands of Christianity and the Islamic faith (Van der Watt, 2012:36, 45). There is a stark contrast between the traditional church leaders, who are often modest in their lifestyle and the leaders of the charismatic churches, with the latter dressed in designer wear, driving luxury cars and jetting over the world preaching the prosperity gospel to all, the flamboyant lifestyles being portrayed as the personification of God's miraculous material prosperity they preach about (Meyer, 2004:448 ; Van der Watt, 2012:45-46).

In these settings, the gospel emphasises all forms of prosperity, riches, health, success, booming businesses, fertility, vitality, decent jobs, power, and even purely material items like luxury vehicles and houses as proof of God's favour and the only signs of genuine faith (Lauterbach, 2019:111,117; Van der Watt, 2012:45). The congregants are told to

give generously in order to succeed like the Pastor, with the deception that the more cash they pay, the more blessings they earn in exchange from God (Masenya & Masenya, 2018:636; Van der Watt, 2012:45). Prosperity is glorified and there is a belief that it is the rightful inheritance of Christians to obtain and enjoy material blessings on this earth (Gbotoe, 2013:71; Jenkins 2007:90; Lauterbach, 2019:117). Tithing is preached as a vehicle for protecting the material blessings, but it often ends up lining the pockets of some church leaders (Van der Watt, 2012:46).

The leaders of churches summoned to the CRL Rights Commission were seen pulling up in the latest luxury cars, surrounded by heavily armed bodyguards (CRL Rights Commission, 2017:18). There have been reports in both traditional and social media platforms showing the church leaders' ostentatious lives (Mahopo,2019; Nyker, 2017; The Citizen, 2020) from which it can be postulated that the compensation received from leading the church is an unreasonable and questionable amount taking into consideration that they are leading non-profit organisations, which ought to be formed solely for the advancement of religion. In the USA the IRS would consider the guidelines indicated in section 4.4.4.2 of Chapter 4, to determine whether the remuneration paid is reasonable, or if it used as a tool to distribute the earnings of the organisation to the leaders. If found to be a distribution of earnings, the remuneration expense will not be deductible (Rogers, 1968:119). Although there has been inconsistency noted in the treatment of the amounts deemed unreasonable (Sikon, 2004:302), this mechanism offers a degree of assurance as each factor and the evidence in support for or against the deduction is not considered in isolation when classifying amounts reported as reasonable compensation. The following "men of God" are the epitome of the prosperity gospel in South Africa, if the media and social media are to go by:

- *The founder of Alleluia Ministries International -Alph Lukau, infamous for resurrecting someone from the "dead", is not reserved about sharing his luxury life consisting of overseas trips, luxury cars with personalised registration, private jets and designer clothes (The Citizen, 2020).*
- *Shepherd Bushiri took to Facebook in 2017 to celebrate his daughter's birthday, with his 4-year-old daughter posing next to a Maserati Levante, said to be worth R1.65 million, adorned with ribbons and balloons giving the impression of it being a gift (Nyker, 2017).*

- *A motor dealership situated in Fourways posted a tweet congratulating Pastor Paseka "Mboro" Motsoeneng on the purchase of his BMW i8 costing R1, 927,700 at the time (ENCA, 2016b).*

Englebrecht *et al.,* (2014:233-234) contend that reasonable compensation in closely held corporations has been an issue often litigated on in the USA and has been a cause of debate since its inclusion in tax legislation. The IRS code (1986) provides for a deduction of "reasonable allowance" in relation to salaries and compensation against taxable income. However, there is no clear definition of what is reasonable or the criteria to determine what reasonable compensation is. This lack of guidance has brought about several judicial methods of determining "reasonable" amounts of compensation, resulting in the use of judicial methods to arrive at what may be considered a "reasonable" amount for remuneration (Englebrecht *et al.,* 2014:233).

In an attempt to demystify "reasonable", a two-pronged test was introduced by Section 162-7(a) of the IRC (1986) which stipulates that for compensation to be deductible it must be (a) "reasonable" in amount and (b) paid for services actually rendered. However, there are still grey areas on how "reasonableness" should be determined, thus placing reliance on judicial principles set in cases, although the exact means of determining reasonable compensation differs from court to court and case to case (Englebrecht *et al.,* 2014:233).

The area of reasonable compensation in religious organisations is an area that needs further research as there exists a possibility that the church may be used as a conduit for self-enrichment and distribution of income collected from the worshipers to the leaders of the church. Unlike in the USA, where excise tax is levied on transactions found to fall under the excessive benefit transaction, the South African tax legislation is silent on what the sanctions would be specifically if a PBO is found to have paid excessive remuneration to its founders or employees, besides the withdrawal of the tax exempt status. The revocation of the tax exemption status may not be a tangible punishment as the culprit may still carry on establishing new organisations and continuing with the same *modus operandi*.

In section 5.6, it was indicated that most religious organisations could not confirm their compliance with financial reporting requirements as per the various legislations governing the sector and they were found to be hostile to the notion of being audited by

external auditors. The CRL Rights Commission (2017) found the same to be true, in that these organisations had serious administrative deficiencies.

Given the growing non-compliance in this sector and the concerns raised by SARS regarding taxes on unrelated trading activities not being properly accounted for and Pay As You Earn (hereafter P.A.Y.E) on fringe benefits not being paid in accordance with the legislation (Rangongo, 2019; SARS, 2018a), it is therefore plausible that the religious organisations do not withhold P.A.Y.E tax on the remuneration paid to the leaders and other employees of the organisations as required by the Fourth Schedule to the Income Tax Act (58 of 1962).

5.9. Lack of governance and accountability in religious organisations

"In the charismatic sector, you start up and report to no one, you report to heaven. If I have a calling tonight, by tomorrow I can buy a tent and a sound system, I can call myself bishop, a prophet, whatever – and I'm good to go … it can't be like that when you have access to vulnerable people" (News24, 2015d).

During the study, it was discovered that there is a lack of governance and accountability in the religious sector. Although this was not the focus of the study, it is important to note as it impacts on the operations of the religious organisations and meeting their tax obligations. As alluded to in section 3.3 in Chapter 3, governance provides a framework for efficient, transparent, and accountable decision-making at any organisation, irrespective of size or ownership. Corporate governance is crucial for any organisation in the civil sector (Marais, 2020:25). Good corporate governance contributes to the success of an organisation and can enhance the operation of leadership structures and guides the governing body in governing the organisation to enable it to meet its strategic objectives (IoDSA, 2016:6). It follows therefore, that the church, as the moral compass of society and steward of the gospel (Musau, 2017:13 ;Tanui *et al.,* 2016:31), should treat accountability as particularly important as the funds donated and use thereof is meant to fulfil religious obligations for the well-being of society (Appiadu, 2019:3). In the absence of an internal control system, financial records will be inaccurate and unreliable, monies mostly derived from tithes, offerings, projects, and contributors, will be lost, and accounting standards will not be followed, which may lead to the church's operations being significantly hampered if there is a financial shortfall (Tanui *et al*., 2016:32)

In accordance with Section 30(3)(b), PBOs are required to make provision in their constitution or founding documents, for the appointment of a minimum of three

unconnected persons to be tasked with the fiduciary duties of the organisations and for decision making powers to not be vested in a single person whether directly or indirectly. The Income Tax Act (58 of 1962) in Section 1 defines what a connected person is, depending on the legal formulation of the organisation (See section 3.4.1. in Chapter 3 for legal identities that can be used by a church). The researcher seeks to suggest that it is not this connectedness defined in the Income Tax Act (58 of 1962) that may be problematic in religious organisations but rather the “connectedness” under spiritual authority and influence that the leader has on those tasked with these fiduciary duties.

The case of Jim Jones mentioned in section 5.2 illustrates the psychological indoctrination that can happen in a religious setting, with leaders of religious organisations using manipulative powers and influence on the entire congregation, including those tasked with fiduciary duties as required by Section 30(3)(b). The South African Neo-Pentecostal Churches are characterised mainly by the self-appointed prophet-pastors or prophet-apostles, who generally maintain sole and absolute control over their churches (Banda, 2020:1). Agazue (2016:2) and Resane (2017:4) indicate that these self-styled pastors or prophets would plant churches on their own and without any accreditation of their qualifications, choose to grant themselves prophetic titles such as “Prophet, Reverend, Pastor, Apostle”, etc. without following the due process of obtaining such titles, and in the process, they exalt themselves over and above other prophets. Such self-assigned titles like “Major One” (used by Bushiri, see headlines about him in section 5.8) catapults the person into a status of a celebrity cult, with the individual elevated to a higher status of beauty, achievement, prestige and power and becoming more important than the calling or the formal position, the result of which is the congregants giving their lives to the founder of the church and not to Jesus (Kgatle, 2019:3; Resane, 2017:4).

The pastor is often referred to as “Papa, Father and Bishop” (CRL Rights Commission, 2017:18; Kgatle, 2019:2; Masenya & Masenya, 2018:636). According to Kalu (2008:124) the phenomenon of spiritual fatherhood refers to a circumstance in which church leaders allow congregants to refer to their spiritual leaders as “fathers in the Lord” transmitting warming images of affection taken from a family environment but used to cover up patriarchal and eldership patterns of authority. The use of these titles depicts and affirms the level of influence and power exercised by these pastors over their congregants. Johnson (2019:1,11) asserts that church goers have clung to some man-made traditions of the admiration and respect they have for their pastors whom they hold in high esteem

and are more scared of than the scripture, and that anything contrary to what the pastor preaches is shunned and they will defend the stance of the pastor.

Cornell, Johnson and Schwartz Jr. (2013:85) state that research has found that the congregation is generally trusting of the church leadership to manage the church's financial matters. Ventura and Daniel (2010) indicate that while church financial statements are relatively uncommon and not standardised across denominations, this deficit does not tend to change the trust of the congregation on whether their donations are being used properly. This sheds light on why the congregants remain loyal to the pastors amid scandals reported against them.

The church is notorious for insufficient internal control and governance systems and those tasked with the leadership of the church may view these as worldly practices and therefore insignificant (Musau, 2017:13-14). It also seems that there are no governance structures in most churches and if there are, the pastors seem to be heads of their church boards or councils and are involved in the nominating and approving of those to serve on the board (for example, Grace Bible Church, 2016:41-43). Having autonomous control over their churches means being in control of the decision-making processes just as a CEO would be in the corporate world, although the corporate world has governance structures in place. There is also an array of laws regulating operations and processes, whereas there are fewer external systems to oversee NPO accountability and many organisations in the sector are self-regulated (Appiadu, 2019:44; Burger *et al*., 2018:10).

It can therefore be argued that with lax internal controls, bad governance and the lack of accountability in the church, there is room for greed and corruption which solidifies internal control systems as critical for directing, monitoring, and controlling church activities, as well as upholding ethics and good governance (Tanui *et al.*, 2016:31,33).

There are three categories of fraud; first being assets misappropriation which occurs when an organisation's assets are stolen or used inappropriately. The second is corruption which arises when power is inappropriately exploited in an economic transaction. Third is the financial statement fraud which is the deliberate falsification of an entity's financial statements (Greenlee *et al*., 2007:684).

The influence of the pastor can have an impact on the behaviour of those nominated for fiduciary duties and serving as an oversight authority in the church which also makes

questionable their impartiality and ability to make independent decisions where the finances of the church are concerned.

The examples below depict what is indicative of blind loyalty to the leadership of the church and not the gospel, and display a lack of accountability by both the pastors and those that may be in fiduciary positions:

Pastor Tim Omotoso

Durban-based Pastor Tim Omotoso, a leader of Jesus Dominion International, is facing 63 main and 34 alternative charges ranging from sexual assault, human trafficking, and rape. During his trial, his supporters are seen outside court carrying placards reading "*Free Tim Omotoso Ubaba wethu*" (translated free Tim Omotoso, our father). In an interview with the media, Mr Chuks (sic), a man introduced as a senior pastor of the church, talks about the "man of god" and the great works that he has done when asked about his support for Tim Omotoso. He continues to say that "*this is a man we know. The man who has influenced our lives positively"* (SABC News, 2020).

Major One Shepherd Bushiri

A video surfaced during the bail hearing of Bushiri portraying grown men and women with tears running down their cheeks, speaking in tongues, weeping for their "Papa" Prophet Shepherd Bushiri, adamant that he was being unfairly persecuted by the state. Another video shows Bushiri's followers praying in tongues, shouting "fire" at the direction of the Hawks[9] vehicle and even sprinkling it with what could be either "holy water or oil" (Molosankwe, 2019; News24, 2019). In another video, a grown man is shouting *"We can't stay without our father. We are behind Major One"* while another lady shouts *"We are who we are because of Prophet Shepherd Bushiri"* (Multimedia LIVE, 2019).

Prophet Lebetho Rabalago

Self-proclaimed Prophet Lebetho Rabalago (dubbed *Prophet of doom*) of Mount Zion General Assembly, was arrested after it came to light that he was spraying congregants with Doom (an aerosol insecticide brand) in order to heal them of illnesses. During his court appearance, some of his supporters wore T-shirts with the words *"Hands off the Anointed One*" written on them (Mahopo, 2017; Makhubu, 2016).

[9] An independent Directorate for priority crime investigation within the South African Police Service

Such behavioural displays as indicated above raises the suspicion that there may be those nominated with fiduciary duties and decision-making powers within some religious organisations who may not be able to exercise their duties with objectivity and this may be exacerbated by the fact that external systems that oversee NPO accountability are few and the sector is self-regulated (Appiadu, 2019:44; Burger *et al*., 2018:10). These accounts also demonstrate that some of these churches do not have a separate identity from that of the founder and if there are oversight bodies appointed and governance structures in place, such as the three unconnected persons, they would not be effective in ensuring that the church operates within the letter of the law. The powers that the leaders of these churches have on the entire organisation may also be used to manipulate the fiduciaries to change the object and function of the church or to handsomely remunerate the leaders.

Section 30(3)(b) of the Income Tax Act (58 of 1962) does not require any specific qualification or minimum requirements to be met before one is appointed for fiduciary duties in an organisation.

5.10. Conclusion

This chapter addressed the second secondary objective as set out in section 1.3.2 of Chapter 1 of the possible misuse of the PBO tax exemption by religious organisations as well as the lack of governance and accountability that can be found in religious organisations.

Religious organisations, being vehicles for the promotion of good citizenship, education, character building, conflict resolution and serving as institutions of good morals, have long enjoyed the embedded trust of the public (Dube 2019:1; Forster, 2019; Goodchild, 2016:5; Musau, 2017:13; Tanui, 2016:33; Taylor, 1982:1204). Taylor (1982:1204) asserts that it is reasonably expected by both the congregation and the general public that church officials will fulfil their religious calling and expend church funds towards the religious purpose and aims. The definition of what the religious purpose is, is difficult, as this is mainly on the discretion of church leaders. Nonetheless, there is a universal expectation that the funds collected by the church will not be diverted for the benefit of private individuals (Taylor, 1982:1204). There is growing evidence that in some cases, the church has been turning into a commodity where the motive is material gain using the prosperity gospel to manipulate people to give their hard-earned earnings in exchange for some miracle or blessing while the pastors leading these churches

continue to amass wealth and live in luxury (Gbotoe, 2013:71-74) as discussed in sections 5.7 and 5.8.

The dealings of some of these churches have been unveiled in recent years with numerous charges of human rights abuses, the commercialisation of the gospel through the vehement preaching centred on gaining of material wealth and possessions, as discussed in section 5.8 above, and the fiscal delinquency. The picture that emerges is that just like secular organisations, religious organisations are also susceptible to fiscal misuse and abuse and there is a need for the government to be more involved in the matters of religion, by strengthening the regulation governing religion and monitoring of its financial activities in as far as application is involved, as opposed to the doctrine itself.

Registration with the NPO Directorate is freely available and voluntary, with no legal obligation to do so. Some organisations opt not to register, hence the number of religious affiliations operating in the country without being registered. As mentioned in section 3.4.1 of Chapter 3, only those organisations that wish to get grants from the government and/or funding from other donors have the incentive to register as this adds to their credence, an advantage when seeking funding (Badenhorst, 2018).

There is a need for more research to be conducted on the extent of financial fraud, mismanagement, and misrepresentation in religious organisations. It is important for several reasons why we need to get an understanding of the fraud and misrepresentation within the religious sector, as money donated is meant to fulfil religious obligations for the well-being of society, and every cent lost is a loss to the congregants and the fiscus, i.e. if accounting records are compiled truthfully, the unrelated business receipts and accruals would be properly taxed in accordance with Section 10(1)(cN)(ii)(dd) of the Income Tax Act (58 of 1962).

The next chapter will contain the findings, recommendations, and the summary of the study as well as discuss the limitations and suggested areas of future research.

CHAPTER 6: FINDINGS, RECOMMENDATIONS AND CONCLUSIONS

6.1. Introduction

The aim of this chapter is to elaborate on the findings of the research conducted with specific focus and consideration of whether the research objectives have been met. This is in order to address the research problem in section 1.2, and to propose recommendations on possible remedies to address the misuse and abuse of the PBO tax exemption provisions by religious organisations in South Africa, as well as to indicate the areas for further research.

The primary aim of the study as outlined in section 1.3.1 was to evaluate the possibility to abuse the PBO tax exemption provisions of Section 10(1)(cN) of the Income Tax Act (58 of 1962), available to religious organisations by studying the current legislation that governs the PBOs.

In order to address the problem statement, the primary objective and secondary objectives were developed, and these were:

a) a discussion on the concept and history of tithes, in order to understand the concept and how it is positioned in modern society, and also to show the motivation for the tax exemption;
b) a discussion on the legislative and governance framework for PBOs, with special focus on religious organisations as well as an overview of the compliance status of the religious organisations in South Africa;
c) to conduct a comparative analysis of the PBO tax exemption for religious organisations between South Africa and the USA, and
d) a discussion of the possible misuse of the PBO tax exemption and the lack of governance and accountability in religious organisations in South Africa.

As explained in section 1.4 of Chapter 1, a qualitative research methodology was used to obtain suitable literature for this study to address the problem statement, and the primary and secondary objectives. This chapter provides the findings and recommendations of this research, outlines the limitations and areas identified for further research as well as concludes on the study.

The study was prompted by the increase in the spread of charismatic Christian churches and the recent years' controversies around the practices of some of these organisations,

which pointed to the direction of the church being commodified through the so-called prosperity gospel whose emphasis is on wealth accumulation.

6.2. Findings

This study showed that historically, the church was the main driving force behind charity and instrumental in delivering social services such as health and education, funded mainly by the tithes and offerings received. It was for this reason that the church was exempted from tax, as discussed in section 2.5. The findings of the research were as follows:

6.2.1. Registration and reporting compliance

South African legislation allows for religious organisations to take on either one of three legal identities, in the form of (1) a voluntary association, (2) a living trust or (3) an NPC, all of which can voluntarily register with the DSD in terms of the NPO Act of 1997.

As discussed in Chapter 3, section 3.5, the NPO sector in general, and religious organisations in particular, have low compliance levels with the regulations of the PBO sector and other regulations aimed at encouraging good governance, effective management, and ethical behaviour, which when applied, enhance self-regulation in the sector. Low compliance levels relating to registration can be attributed to the fact that there is neither an incentive to comply nor any consequences for not complying with regulations and the fact that legislation is written in such a way that it is a voluntary option by nature. The incentive for NPOs to register with the DSD and SARS is the credibility it adds, and that registration boosts the level of trust in those wishing to donate to the NPO as well as being able to issue donors with a donations tax certificate which they can use to deduct the donations from their tax liability (Badenhorst, 2018). While ordinary NPOs are dependent on donor funding and government grants, churches mainly rely on tithes and offerings as sources of income to operate, which do not attract any donations tax for the donors and is also not deductible in terms of Section 18A of the Income Tax Act (58 of 1962).

The lenient environment provided for the operation of PBOs and religious organisations in particular, creates an opportunity for the formation of bogus organisations whose main drive seems to be the making of money and benefiting the founders, as discussed in sections 5.7 and 5.8 of Chapter 5. The application of a more stringent approach to the enforcement of the existing legislation will not equate to the state interfering with religious freedoms as some may lament. The separation of church and state will not be

threatened by the implementation and enforcement of what is already law but can assist to guard against the undermining and abuse of this very religious freedom.

6.2.2. Financial management and reporting

In section 5.4 of Chapter 5, a discussion ensued on the financial scandals involving religious organisations and their leaders. Religious organisations, in the same way as secular organisations, are also susceptible to financial mismanagement and misappropriation of funds and this is mainly due to poor control systems as well as the limited monitoring from congregants and the government (Ahiabor, 2013:115; Rockson, 2019:21; Taylor, 1982:1204). The planning, monitoring, and controlling of an organisation's funds are important in ensuring that the organisation achieves its objectives, while the mismanagement thereof can have a ripple effect not only on the organisation but the society as a whole. The lack of internal controls and systems renders religious organisations vulnerable to the threat of financial fraud (Ahiabor, 2013:115; Tanui *et al.*, 2016:31,33). The function of financial management is very important within any organisation and failure to implement adequate and appropriate systems can lead to the collapse of an organisation.

The preparation of annual reports in accordance with applicable accounting standards is a crucial function because it provides legitimacy to the organisation and gives an account of activities and financial transactions to donors and stakeholders alike and also assists in the governance and accountability of organisations (Dhanani & Connolly, 2012:1140-1141; Zainon *et al.*, 2013:183-184).

It emerges that some of those tasked with leading the religious organisations and those tasked with fiduciary duties within the organisations may have a lack of knowledge of the NPOs Act (71 of 1997) which specifies the legal obligation of organisations to present annual financial statements and other required financial reports to stakeholders and the authorities, as well as to make these publicly available, as shown in section 5.6 of Chapter 5 (CRL Rights Commission, 2017:19; BMR, 2016:119-120). In addition to this, some organisations do not welcome the notion of being subjected to external audits and believe that this information is private and not for the public (BMR, 2016:120). The investigation of the CRL Rights Commission is evidence to this non-compliance as shown during their investigation where most leaders of religious organisations selected for review refused to co-operate when the CRL Rights Commission wanted to probe their financial management practices (CRL Rights Commission, 2017:17).

The impression gained by the study is that some religious organisations believe that the tax exemption status grants them a totally tax-free status even though they may be conducting commercial activities that are unrelated to the primary PBA. This is evidenced by the fact that none of the churches, except for one church, discussed in Chapter 5 section 5.6 and section 5.7, accounted for taxation on unrelated business income, even though there was income earned from impermissible trading activities.

6.2.3. Distribution of income, promotion of self-interest, and reasonable compensation

The prosperity gospel, as discussed in section 5.8 in Chapter 5, places emphasis on wealth accumulation, and with the leaders' amassing of wealth being presented as testament of their faithfulness and as a tool to encourage congregants to contribute even more into the church coffers, which in most cases end up lining the pockets of these leaders (Dube *et al.*, 2017:337; Gbotoe, 2013:71; Masenya & Masenya, 2018:636; Van der Watt, 2012:45).

Religious organisations, like all other PBOs, are prohibited by the NPO Act (71 of 1997) and the Income Tax Act (58 of 1962) from forming tax exempt organisations to distribute funds donated for the advancement of religion in order to, directly or indirectly, benefit the founders or any other person. This legislation also prohibits the payment of compensation that is excessive and unreasonable.

However, evidence seems to point to the transgression of the income distribution prohibition clause as stipulated in Section 30(3)(b)(ii) of the Income Tax Act (58 of 1962), judging by the lifestyles of leaders of some religious organisations and the findings of the CRL Rights Commission (CRL Rights Commission, 2017:18; Masenya & Masenya, 2018:636; Van der Watt, 2012:45). Table 5.1 in section 5.6 illustrates that some churches expend over 80 percent of their income on employment costs which may be an indication that there is excessive payment of remuneration.

The South African legislation does not provide any guidelines to determine what can be deemed to be reasonable compensation paid in the sector. Although certain organisations have some guidelines on the remuneration of pastors (Sola5, 2017), the limitation with these guidelines is that they are only applicable to the affiliated denominations and are not industry standard. Section 30(3)(d)(ii) of the Income Tax Act (58 of 1962) refers to the industry standard for the payment of remuneration in the PBO sector, however, none can be found for benchmarking compensation in the religious

sector, as indicated in section 4.3.5.1 of Chapter 4, unlike in the USA where the courts and the IRS have developed guidelines and factors used to determine the reasonableness of compensation paid, as indicated in section 4.4.4.2. of Chapter 4.

The researcher is of the view that the revoking of the exempt status, as indicated in Section 30(5) of the Income Tax Act (58 of 1962), doesn't seem much of a deterrent as the legislation is silent about the formation of organisations in the future, as a person whose organisation's tax exempt status has been withdrawn may continue operating or form another similar organisation with impunity (see discussion in section 4.3.7 of Chapter 4 and Chapter 5, section 5.8).

As indicated in section 5.8 of Chapter 5, SARS (2018a) has lamented the general non-compliance of the religious sector and raised issues regarding the non-taxation of fringe benefits advanced to leaders of the organisations (Rangongo, 2019; SARS, 2018a). Given this state of affairs, there exists a possibility that PAYE might not be withheld and paid over to SARS.

6.2.4. Commercialisation and unrelated business income

Churches have become key economic players with multiple revenue streams from commercial undertakings. There are assertions that some religious organisations have a higher net worth than many of today's leading enterprises (Appiadu, 2019:2). Some of the churches are owners of various business ventures and are also run in a manner akin to secular profit-making organisations with departments for sales, advertising, marketing, and public relations, while some of these functions are even outsourced (Appiadu, 2019:2; Rockson, 2019:2; Ukah, 2003:150-161; Van der Watt, 2012:47).

Furthermore, these commercial activities are not related to the principal objectives of the organisations. It was demonstrated in section 5.7 of Chapter 5 that a few churches are involved in significant business deals with some of the biggest role players in the market such as Vodacom, and undertaking business ventures such as bookshops, coffee shops, manufacturing factories, funeral schemes, venue hire, and malls. These business activities are not negligible and may form a great percentage of the total income derived by the organisation. This presents the challenge that religious organisations end up having an unfair advantage over secular commercial entities that are liable for the payment of taxes without the benefit of a basic exemption on commercial earnings.

6.2.5. Good governance

The mandate of the CGP issued in 2001, was to foster good governance, effective management, and ethical behaviour in accordance with the self-regulatory structure of the NPO sector as indicated in section 3.5. This code was drafted not to be prescriptive but rather used as tool to encourage NPOs to use those aspects that they find useful and relevant to them. The loophole of this code was its voluntary nature which meant that it could not be enforced and could not hold the NPOs accountable. DSD (2009:11) found that the compliance levels were low, and the reason could be that NPOs believe that there are no consequences for failure to report.

Good governance and accountability are of paramount importance in the non-profit sector, particularly in the church, which holds a higher moral ground than secular entities and mainly relies on the benevolence of the congregation for the accumulation of funds donated, which are meant to be used to advance religious activities for the well-being of society as a whole (Appiadu, 2019:3; Musau, 2017:13).

Although there is a provision in the tax legislation for the appointment of a minimum of three unconnected persons who will be custodians of the fiduciary duties and decision-making powers in the organisation, evidence suggests that this is an inadequate measure, as it does not consider the spiritual connectedness of these people to the leaders that may impede the implementation and application of governance and accountability measures, if they exist at all, as illustrated in section 5.9 of Chapter 5 (Appiadu, 2019:44; Burger *et al.,* 2018:10). In Chapter 5, section 5.9, the study demonstrated that so loyal and indoctrinated are the members of the congregation to the pastor, that they will defend him/her at all costs and will reject anything contrary to what the pastor preaches, despite the evidence at hand (Johnson, 2019:1; Kgatle, 2019:3).

Governance structures are often viewed as worldly by many churches, and therefore inconsequential, and if there are structures in place, they are often headed by the leader who yields control and power over the appointment of the boards and council which can render the application of governance and accountability systems ineffective.

6.3. Recommendations

Considering the findings above based on the research conducted, the following recommendations are made to aid the administration of Section 10(1)(cN) and Section 30 of the Income Tax Act (58 of 1962):

6.3.1. Religious organisations' criteria

One of the stark differences between SA and the USA is that in the USA, the IRS has a set of criteria used in order to determine if an organisation is a *bona fide* church. This is something that is lacking in the South African tax legislation as the provisions of Section 10(1)(cN) and Section 30 of the Income Tax Act (58 of 1962) are generic for all NPOs, although religious organisations have distinct characteristics compared to ordinary NPOs.

An organisation only has to satisfy that the activities conducted are for the promotion and practice of religion in order to be deemed as a PBO and can thereafter apply for tax exemption. In a pluralistic society such as ours, perhaps the task of enumerating the criteria defining what religion and religious practice is, can be too burdensome.

However, considering the rapid spread of churches and the seriousness of the unintended consequences of the prosperity gospel, this is something that the regulators of the sector need to look into. It is recommended that a similar approach to that used in the USA (as discussed in section 4.4.2, Chapter 4) can be adapted to the South African context. Further to this, due to the distinct characteristics of religious organisations, it is recommended that, similarly to recreational clubs having their own tax exemption provisions in the Income Tax Act, there should also be separate and specific provisions for the tax exemption of the religious sector, instead of having them clustered under one umbrella of PBOs.

6.3.2. Registration of religious organisations

Section 12 of the NPO Act (71 of 1997) uses the words "intends to" which may be construed to suggest that the laws therein apply only to organisations intending to register and those already registered with the DSD. Because there is no obligation on PBOs to register with the DSD, this can lead to the assumption that this legislation is not enforceable unless the organisation is registered with the DSD and may lead certain organisations to labour under the impression that they can operate without being accountable to anyone. There needs to be concerted efforts from all spheres of government to ensure that religious organisations operate within the letter of the law. There are proposed amendments to the NPO Act (71 of 1997) including a proposal to compel all NPOs operating in South Africa to register with the DSD and to be subject to all the laws of the country (NPO, 2021). This is a welcome proposal as it would bring all organisations under the radar of the DSD, making it easier to regulate the sector.

6.3.3. Financial management and reporting

In section 5.4 of Chapter 5, it was demonstrated that religious organisations also face the risk of financial mismanagement and misappropriation of funds just as corporate organisations do. This can be attributed to inadequate control systems and the limited regulation by congregants and the government (Ahiabor, 2013:115; Rockson, 2019:21; Tanui *et al*., 2016:31,33; Taylor, 1982:1204). Financial management is crucial in any organisation and failure to implement adequate and appropriate systems can lead to the failure of an organisation.

Preparing annual reports aligned to applicable accounting standards is important as it provides legitimacy to the organisation, gives an account of activities and financial transactions and also assists in the governance and accountability of organisations (Dhanani & Connolly, 2012:1140-1141; Zainon *et al*., 2013:183-184).

The NPO Act (71 of 1997) stipulates that an organisation must keep accounting records and financial statements must be prepared in accordance with the standards of GAAP as well as submit a narrative financial report and the accounting officer's report. Southern African Institute for Business Accountants (hereafter SAIBA) (2015:11) indicates that NPOs would generally prepare financial statements using the standards mentioned in section 5.6. taking into account the legislative requirements, donors or grant specifications, and the nature and scope of activities undertaken by the NPO.

To assist in holding the PBOs including religious organisations, accountable to the public, it is recommended that the DSD should publish the annual reports depicting both financial and non-financial information of these organisations on their website to make it accessible to the public as in accordance with Section 25(2) of the NPO Act (71 of 1997). This information is currently not available on the DSD website.

The DSD has reported the challenges with personnel capacity to carry out its mandate as discussed in section 5.3. In section 3.5., the NPO Act (71 of 1997) is silent on the need for monitoring and evaluating NPOs and it is indicated that there is insufficient research to determine if the state has implemented an effective system to monitor and evaluate the organisations (Monyane, 2014:23,24).

It is on this basis that it is further recommended that the NPO Directorate has to be adequately capacitated with suitably qualified personnel such as financial inspectors, who will monitor and evaluate the organisations for adherence to the legislation, to

ensure that all organisations are compliant to the requirements of certification issued under the NPO Act (71 of 1997).

6.3.4. Basic tax exemption on the unrelated business income

The American legislation subjects any income derived from unrelated trade or business to taxation at the prevailing corporate rate, whereas South African legislation allows for the deduction of a basic exemption prior to calculating taxable income from unrelated business or trade activities. This presents religious organisations with an unfair business competition over tax paying entities. A church bookshop, such as the ones mentioned in section 5.7, Chapter 5, that is conducting the same business will have the benefit of having a basic exemption up to R200 000 deducted from its income before tax is calculated.

It is recommended that the basic exemption of Section (10)(1)(cN)(ii)(dd) of the Income Tax Act (58 of 1962) be abolished for religious organisations, and all trade or business income not directly related to the core tax exempt purpose be subjected to normal tax from the first Rand. It is also recommended these unrelated commercial activities be housed under a separate tax-paying entity that will be registered with SARS, apart from the religious organisation, in order to separate receipts and accruals from tithes from those derived from commercial activities. Making all commercial activities subject to tax without the deduction of any basic exemption might reduce the ability of religious organisations to play the system by allocating income and expenses from non-exempt activities to the tax exempt activity, in order to reduce the tax liability resulting from these activities.

6.3.5. Introduction of the excess benefit transaction concept

The principle of excess benefit transaction should be introduced into the South African tax legislation to impose penalties on any transactions found to be distributed for the promotion of personal economic interest as well as those that are entered into in order to distribute funds to the founders of the organisations. The IRS imposes excise taxes of 25 percent, not exceeding $20 000, on each transaction involving excess benefits granted to insiders of the tax exempt organisation in addition to the option to revoke the tax exempt status of the organisation. Should the organisation fail to rectify the transaction within a given period, the transaction will attract an additional 200 percent penalty (IRS, 2020; IRS, 2021).

This serves as a deterrent to discourage the formation of PBOs solely for the economic benefit of insiders and seeks to penalise individuals who have improperly benefited from transactions, and in certain instances, the officers or directors who have approved the transaction, as opposed to revoking the tax exemption status of the organisation, which ultimately could lead to the suffering of the charity and its beneficiaries, and not those guilty of private inurement.

Additionally, in the USA, the IRS allows for the remuneration expense to be deducted from taxable income, limited to an amount deemed to be reasonable in terms of Section 162(a)(1) of the IRC (1986). Any amount deemed to exceed reasonable remuneration is classified as a dividend payment and not allowed as a deduction from taxable income (Englebrecht, Holcombe & Murphy, 2014:233; Sikon, 2004:301-302). The introduction of similar criteria as listed in section 4.4.4.2 may serve as a deterrent for organisations paying remuneration exceeding what may be deemed reasonable.

SARS, on the other hand, only has the option to withdraw approval should an organisation be found in transgression of Section 30 and there has not been any litigation (as far as the researcher could determine) relating to reasonable compensation in the sector.

6.3.6. Governance

The lack of governance structures in charismatic churches was one of the primary concerns of the CRL Rights Commission (2017) in their investigation of the practices of religious institutions. There is an increased need for improved governance, and this can be done by focusing efforts on educating stakeholders in the religious sector. It is recommended that the three unconnected persons tasked with fiduciary duties should include at least one person unaffiliated with the organisation, and preferably a person who has to account to a legal or financial professional body such as an accountant or attorney.

6.3.7. Amendment of Section 30(3)(e) of the Income Tax Act

Section 30(3)(e) of the Income Tax Act (58 of 1962) provides that a PBO will be approved once it complies with reporting requirements as determined by the SARS Commissioner but does not state beforehand what these requirements are.

It is necessary to know that the reporting requirements are made explicit in order to ensure that the founders and other role players within the PBO sector know exactly what is required.

6.4. Areas for further research

The following areas present opportunities for further research:

- Studies on the revenue generated by religious organisations and how that is utilised for social development programmes or other programmes that benefit the public.
- A study needs to be conducted on what is considered reasonable compensation in the religious sector.
- Further research should be done on the regulation of churches across the globe with potential and possible suggestions for the increased regulation of churches.

6.5. Summary

The main aim of this study was to evaluate the tax exemption provisions provided to PBOs, in particular religious organisations, and how these provisions are susceptible to being misused and abused. The study concludes that there are indeed abuses and misuse of the tax exemption provisions available to the PBO sector by religious organisations.

The rapid growth of the charismatic movement and the scandals reported in recent years indicate that there is a need for greater intervention and co-operation of inter-governmental institutions like SARS, the DSD and the CRL Rights Commission. There is a cause for concern that there has been a growth in the commercialisation of the religious sector and that the tax exemption is being applied on activities that ought to have been taxable. Although there is a need for training and educating of religious organisations in particular, as well as those in leadership or positions of authority, to assist them to meet the legislative obligations, there is also a need to enforce the law for those who are wilfully non-compliant.

It can therefore be concluded that non-compliance is a risk in the PBO sector in general, and in the religious sector in particular, especially in the charismatic churches, which presents a need for greater intervention towards the regulation and monitoring of these organisations, in order to determine the justification for continued tax exemption.

There needs to be adequate regulation and scrutiny of the PBO sector, in order to ensure that no organisation will derive any unfair benefit of being exempted from tax on income derived from secondary commercial activities.

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