06 July 2010

South African Revenue Service
Private Bag X923
PRETORIA
0001

BY E-MAIL: mnaidoo@sars.gov.za

Dear Sir

VAT RULING APPLICATION: ANNUAL SUBSCRIPTION INVOICES
VAT NUMBER: 4570104366

We hereby apply for a ruling to the South African Revenue Services (“SARS”) to allow a deduction of VAT paid on SAICA subscription fees in the hands of employers paying the subscription fees on behalf of SAICA members.

This document sets out the arguments for a deduction. We confirm at the outset that that SAICA does not permit corporate memberships in terms of its governing statutes, i.e. only chartered accountants (i.e. individuals) are eligible for membership.

The VAT Act
Input tax is defined in paragraph (a)(i) of the definition of “input tax” in section 1 of the Value Added Tax Act (“the VAT Act”) as “the tax charged under section 7 and payable in terms of that section by a supplier on the supply of goods or services made by that supplier to the vendor” to the extent that such goods or services are acquired by the vendor for the purpose of consumption use or supply in the course of making taxable supplies.

The Scheme of the VAT Act
The overall scheme of the VAT Act is aimed at taxing the final consumer of goods or services. All VAT incurred on the procurement of goods or services used, consumed or supplied in the course of making taxable supplies must be taken into account in the final determination of the amount of VAT payable by the end consumer.

The VAT Act contains specific categories of non-deductible input tax, essentially being VAT incurred on the supply of entertainment, a motor car and “in respect of fees or subscriptions paid by the vendor in respect of membership of any club, association or society of a sporting, social or recreational nature”.
The reason for the disallowance of VAT incurred on the above categories of expenses is, due to the nature of the supplies, it is regarded that the beneficiaries of the supplies are the individuals who benefit directly from the supplies (for example consuming food or drinks) in the process of producing the final product. Consumption therefore has to be taxed at that level (be-it in the course of the production process). The disallowance of VAT incurred on such expenses is therefore essentially a self-supply mechanism.

**The law**
The VAT Act does not contain a definition of the term “supplies … made .. to the vendor”. The issue has also not been ruled upon by the South African Tax Courts.

The issue has however been addressed in a number of foreign cases.

One of the leading cases (subsequently cited in various other cases) is the case of Customs and Excise Commissioners v Redrow Group plc [1999] BVC 96. In that case the court held that:

“The fact that someone else, in this case, the prospective purchaser, also received a service as part of the same transaction does not deprive the person who instructed the service and who has had to pay for it of the benefit of the deduction”.

The court further held that:

“Once the taxpayer has identified the payment the question to be asked is: did he obtain anything - anything at all – used or to be used for the purpose of his business in return for the payment? This will normally consist of the supply of goods or services to the taxpayer. But it may equally well consist of the rights to have goods delivered or services rendered to a third party. The grant of such a right is itself a supply of services.”

In the subsequent case of British Airways plc [2000] BVC 2207, the Court followed the Redrow principle. The case dealt with meals supplied to BA passengers on delayed flights by third party contractors. On the issue of whether anything was supplied to BA, the court held:

“Yes, it [BA] obtained the right to have its delayed passengers fed at its expense –and that was clearly for the purpose of the business. That is enough to enable it to success”.

In the cases of Poladon Ltd [2001] BVC 4046 and London Borough of Camden [2001] BVC 4219, the courts refused to apply the Redrow principle on the basis that the taxpayer did not contract with the supplier.

New Zealand courts also apply the principle that the entity that has an agreement with a supplier for a supply is the recipient of that supply (even if the supply is supplied to a third party).
In Commissioner of Inland Revenue v Capital Enterprises Ltd (2001) 20 NZTC 17, 511 (AT PARAGRAPH 50) it was held that the core provisions of the NZ GST Act are directed to contractual arrangements between the suppliers and the recipients of the supply and that GST “attaches to the supply to the person who at contract can require its performance.”

In the more recent EU case of Mono Global Limited heard on 25 February 2004 the court seems to have deviated from the strict application of the contracting party principle and also considered the commercial beneficiary. It held that:

“We consider that the decision in Redrow is apt to resolving this appeal. In the present case we consider that the services were supplied to the Appellant. It was the prime beneficiary. Any benefits received by 3i were incidental. Indeed, it seems that on certain aspects at least 3i had its own “in house” advisers. Given the decisions in Reed Personnel and Eastbourne Town Radio Cars Association the exact contractual relationship concluded by the professional advisers does not necessarily determine the identity of the party to whom the supply is made”.

Summary of principles

i. The over-arching principle is that the VAT burden should be borne by the final/end consumer and that no cascading effect should occur in the course of the production process.

ii. The majority of foreign legal precedent seems to follow the principle that VAT follows the contractual agreements. Beneficiaries other than the contracting parties should be ignored in the enquiry as to whom a supply is made.

iii. In the case of Mono Global Limited the court seems to have deviated from the above principle applying a test more closely aligned with identifying the economic beneficiary of the supply.

Application of the above principles

i. If the principle of contractual relationship is applied, SAICA would be making supplies to its members irrespective of whether a third party (the employer) pays for or enjoys the benefits of the actual subscription, the contract for the supply being between SAICA and its members. The employer would therefore not be entitled to recover VAT paid on the subscriptions.

ii. The above approach would however infringe on the principle that consumption should only be taxed at the final consumer/user level. This approach will cause an unintended cascading and inflationary effect in the VAT supply chain. In reality the commercial consumer of the benefit of the SAICA subscriptions is the employer that pays the subscription fees. The CA’s skills and expertise is enhanced and maintained for the direct benefit of the employer in better executing his/her contractual obligations to its
employer. We therefore believe that a persuasive argument exists for the contention that the true consumer of the benefits of the membership is the employer of the CA.

iii If the approach in the Mono Global case is followed, a persuasive argument can be developed for the contention that the commercial recipient of the supply is the employer. The following arguments can be forwarded in support of this contention:

a. Membership of SAICA is a condition of employment and as such is a cost of employment to the employer. The only reason why the members have to contract directly with SAICA is that SAICA does not allow for corporate memberships.

b. The benefits of SAICA membership accrue directly to the employers, as members will fully utilize any membership benefits (continued professional development, etc.) for the benefit of the employer (being in full time employment of the employer). As such the substance of the transaction is that the employers consume the service in the course of its taxable activities (as opposed to the legal form considering only the contractual relationship).

iv The following further arguments can be advanced in support of the contention for VAT incurred on SAICA subscriptions qualifying as input tax in the hands of employers:

c. It could be argued that employers are undisclosed principles for the supplies made by SAICA. This arrangement is necessitated by the fact that SAICA does not allow corporate membership. Under this argument SAICA would be deemed to supply the services to the employers in terms of section 54 of the VAT Act, notwithstanding the fact that the invoices are issued in the names of the individual members.

d. It could further be argued that not allowing the deduction to employers gives rise to a number of anomalies in practice. For example chartered accountants practicing in their private capacity or in partnership will be allowed a deduction while practicing through an incorporated entity would deny a deduction. In each instance the commercial beneficiary of the SAICA membership accrues to the business; the business form however results in a different VAT treatment.

e. Consideration should also be given to the fact that the issue is not limited to the accounting professions. Most other professional bodies have membership rules similar to SAICA.

v. Section 17(2)(b) of the VAT Act determines that vendors may not deduct any amount of input tax in respect of fees or subscriptions paid in respect of membership of any club, association or society of a sporting, social or recreational nature. The VAT Guide for Vendors (VAT404) contains the following comments on the application of this prohibition:
“The VAT incurred on any fees or subscriptions to professional organizations may also be deducted to the extent that membership relates to taxable supplies made by the vendor. Examples of these professional organizations can be found in the financial services industry as well as the accounting, auditing, insurance and medical professions. Only if the employer has an obligation to bear the cost of the employee’s subscription to the professional organization in terms of an employment contract may the employer deduct the VAT incurred as input tax. This is also limited to the extent that the employer makes taxable supplies.”

Ruling request
i  We request the Commissioner’s confirmation that the practice set out in the VAT 404 also applies to individual membership, as in the case of SAICA members.

ii  We request that the Commissioner allows the deduction of the input tax even if the employment contract does not specifically state that the employer will pay for the costs. The mere fact that the employer pays for the expense/reimburses the costs is evident that the employer regards the cost to be for its account and not that of the employee. Therefore, to the extent that an employer can proof that the cost was actually paid by it, he VAT incurred should be allowed as an input tax deduction.

iii  Alternatively we recommend that the Commissioner introduces a new deeming provision into the VAT Act deeming supplies made by professional bodies to its members to be made to the employer provided that the membership is a condition of the employee’s conditions of employment and are consumed in the course of making taxable supplies by the employer/vendor.

Please do not hesitate to contact us, should you have any questions regarding the above.

Yours faithfully

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