Dear Sir / Madam

VAT: COMMENTS ON DRAFT INTERPRETATION NOTE: SUPPLIES MADE FOR NO CONSIDERATION

We thank you for the opportunity to provide input on the draft interpretation note (“draft IN”) regarding “Supplies made for no consideration” that was issued by the South African Revenue Service (SARS). We set out below the SAICA VAT Sub-Committee’s (a Sub-Committee of SAICA’s National Tax Committee) submission comments.

General comment

With respect to the effort than must have gone into the preparation of the draft IN, the structure of the IN creates the impression of an academic dissertation. As such it is cumbersome to apply the IN for the purpose of applying the law under review in practice. In a self-assessment environment, certainty should be a non-negotiable element of tax law. The IN in its current form leaves the decision to the vendor with limited guiding principles to base the decision on.

The applicability of section 10(23) is in our opinion also not dealt with adequately. Section 10(23) does not deal with the value of taxable supplies; it merely deals with the value of supplies. Due to the wide definition of supply in the VAT Act, there can be no argument that a supply is made if something is transferred between two parties. The only issue for consideration is whether the supply is a taxable supply as defined in the VAT Act. The IN needs to be very clear on this issue (based on the correct interpretation of the governing law).

The IN also does not consider the tests for qualifying as input tax, i.e. used, consumed or supplied in the course of making taxable supplies. The IN assumes that everything that is transferred between two parties are supplied as envisaged in the VAT Act, ignoring the possibility that such goods could be held to be either used or consumed in the course of operating the enterprise (for example handing out (supplying)) advertising material. It is essential that the IN provides clear guiding principles where the dividing line is between used,
consumed or supplied for VAT purposes. The VAT outcome may be significantly different for each test.

We suggest that the discussions regarding municipalities and public authorities be incorporated into the relevant Interpretation Notes that deal with these entities and the discussions regarding associations not for gain in the VAT 414 guide.

One of the criteria of whether or not a person is liable to register hinges on an activity/enterprise carried on and *in the course of which* goods or services are supplied for a consideration. Similarly, one of the criteria of the definition of input tax is whether the goods or services are acquired by the vendor for purposes of consumption, use or supply *in the course or furtherance of his enterprise*. Equally, section 7(1)(a) only imposes VAT on goods or services supplied by the vendor *in the course or furtherance of his enterprise*.

The phrase “*in the course of*” as used in the context of an enterprise is described in the dictionary as meaning: in the course of nature, as part of the normal sequence of events; undergoing the (specified process). These definitions seem to suggest that any costs incurred for business purposes or any supplies made as part of the business venture will be in the course of the business, regardless of the necessity thereof or the profitability thereof.

Therefore, we are of the view that any goods or services acquired by the vendor for purposes of supplying same as part of the business’ Corporate Social Responsibilities (CSR) such goods or services will by implication be acquired in the course of the vendor’s enterprise, except where the supplies concerned are exempt and subject to any potential apportionment requirements where the vendor makes dual supplies. This view is firstly based on the fact that some of the CSR are required by law. However, where the vendor has no legal obligation or has fulfilled its minimum CSR but decides to continue to with further CSR, such vendor can clearly not be prohibited the input tax purely because there is no statutory obligation. Equally, we are of the view that should a vendor, assuming one who only makes taxable supplies, decide to acquire goods specifically or to donate trading stock either as part of his CSR or for another reason to any association not for gain, such goods are equally supplied in the course of his enterprise. As is the case with any other expense, these will be subject to the same budgetary requirements, procurement processes, accounting disclosure etc. In other words, these expenses directly influence the gross profit or net profit, as the case may be, in the same way as any other stock items or expenditure.

As far as the term “*furtherance*” as used in the abovementioned context is concerned, the dictionary defines it as meaning “advancement of a scheme or interest”. Based on this meaning, we consider that any goods or services acquired and any supplies made for purposes of advancing the business will be in the furtherance of the business, regardless of whether the goods or services are acquired or supplied for purposes of realizing a profit. We are of the view though that the reference to advancement certainly suggests that a vendor will have to consider the potential reaction/benefit to the business as a result of the business supplying goods or services free of charge, in other words, the “what’s in it for the business?” factor. The most obvious ones are promotional items or free samples. However, “donation” as defined only requires that no identifiable direct valuable benefit in the form of the supply of goods or services to the donor should occur. In other words, where the vendor makes a
donation to an association not for gain in the hope that either the beneficiaries of that Association or the community or part of the community, who will most likely become aware of the charitable gesture, may be more supportive of his business, such donation will still constitute a donation as defined, but would certainly have been made for the advancement of his enterprise. As SARS has admitted, where an association not for gain merely recognizes the donors in its annual financial statements, the potential advertising benefit which may be derived there from does not disqualify the goods or services supplied for no consideration as a “donation”.

Regarding the common law definition of “donation” as sited by SARS, we do agree that it differs from the term “donation” as defined. In this regard the two important words are “disinterested” and “benevolence”. The dictionary describes the first mentioned as meaning “not influenced by considerations of personal advantage” whereas the second is described as meaning “well meaning and kindly” and “serving a charitable rather than a profit motive”.

Thus the determining factors of whether or not any given supply for no consideration made to a person/persons other than an association not for gain, constitutes a “donation” in the common law sense, are facts specific and cannot be categorized by a statement that only welfare organizations can make such “donations” in the course of their enterprise. As said earlier, if a vendor decides to donate blankets for example to residents in an informal settlement in the hope that these residents will rather support his business as opposed to his competitor’s, such supplies do not in our view constitute “donation” in the common law sense.

Therefore, we are of the view that the draft IN should rather concentrate on the principle issues supported by examples.

Specific comments

Page 9, heading: “in the Republic or partly in the Republic”: The draft IN states the following: “It is a requirement of an enterprise that the supplies must be made in, or be wholly or partly connected with, the tax jurisdiction of South Africa.” This comment is a gross generalization of the technical requirement that it is the enterprise or activity that must be carried in, or partly in South Africa.

Page 10, 2nd paragraph, 2nd sentence: The example is not clear enough to come to this conclusion. For example, it should be clear that the printing activity referred to be distinguishable from its taxable activity, i.e. this should not be a conclusion.

Page 10, 2nd paragraph, last sentence: the draft IN states the following: “Input tax may also not be recovered ... if the activities do not give rise to a supply of goods or services to any other person.” Once again, it should be clear that the activities referred to are not enterprise activities in their own right, nor are they activities forming part of an enterprise.

Page 12, footnote 32, last sentence: it is stated that “Prepayments ... are taxable...”. VAT is imposed on supplies, as opposed to income.

Page 13, last sentence running over to page 14: the way it is stated gives the impression that there must be an acknowledgement of some sort.
Page 14, 2nd paragraph: it is stated that “…the donor may not deduct any input tax on any donation made.” This statement is premature and out of context, e.g. it is accepted that input tax in respect of CSR expenses can be claimed.

Page 14, paragraph (a): it is stated that “[a] vendor cannot make a —donation out of pure liberality …. Consequently, as a general rule, input tax cannot be deducted on any goods or services which are acquired for the purpose of making that donation.” These statements are contradictory.

Page 14, paragraph (c): this statement is too simple and should be qualified.

Page 15, paragraph 5.1.6, 2nd paragraph, 1st sentence: this statement is not correct – refer to above comment.

Page 17, paragraph (a), 2nd and 4th sentences: without discussing the ‘composite versus mixed supply’ topic, these sentences are contradictory. Why is a split not required when the free item is subject to VAT at the zero rate?

Page 18, paragraph (e): the reference to “…these supplies are regarded as integral to the making of other taxable supplies...”. This is a good example of where the reference should include a reference to “in the course or furtherance of an enterprise”.

Page 26, paragraph (a): this was the outcome of the case, under a specific set of facts. It is not clear whether the statement made under this paragraph refer to general principles, i.e. outside the context of the decision (which, it should not).

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

Yours faithfully

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