Call for comment file
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Legal and Policy Division
South African Revenue Service
Private Bag X923
PRETORIA
0001

By e-mail: policycomments@sars.gov.za

Dear Sirs

CALL FOR COMMENT: DRAFT UPDATED GUIDE FOR ASSOCIATIONS NOT FOR GAIN AND WELFARE ORGANISATIONS (VAT 414)

Set out below, please find comments from SAICA’s National Tax Committee regarding the above-mentioned document that was released on your website for comment.

General comments

As a general observation the Draft VAT 414 has been well thought through and is of a good technical quality. The examples provided in the Draft VAT 414 are very useful and practical and should assist with the application of the appropriate principles by organisations affected by the relevant VAT rules.

We provide the following general comments for your considerations and trust that it will assist you to further enhance the quality of the document.

1. CHAPTER ONE – Introduction

1.1. Paragraph 2

Sentence starting with “While the occasional sale of goods … “ This may potentially create some confusion in the minds of the users in that they may see “the occasional supply of goods” as always not being part of the enterprise, irrespective of whether the vendor is already carrying on a VAT enterprise for other activities. We recommend that the current wording of this paragraph be
reconsidered to avoid an unintended interpretation regarding the extent of an enterprise carried on by these organisations.

1.2. **Paragraph 4**

We refer to the sentence “These two types are specifically defined persons in the VAT Act.” Technically the definition of “person” in section 1 of the Value Added Tax Act No. 89 of 1991 (VAT Act) does not refer to these kinds of organisations by name. We recommend that consideration be given to changing the reference to “specifically defined” to “included in the broader definition of person …”.

2. **CHAPTER TWO - Definitions**

2.1. **Paragraph 2.1.2**

We recommend that you give consideration to changing “Exempt supplies include the following” to “Examples of exempt supplies include the following”, as the list provided in the Draft VAT 414 does not include all categories of exempt supplies and this may cause confusion in less sophisticated uses of the Draft VAT 414.

2.2. **Paragraph 2.3**

We recommend that consideration be given to stating more explicitly that not all section 21 companies qualify automatically as associations not for gain or welfare organisations. Currently the Draft VAT 414 does state “some section 21 companies”, but as this if often an area of great uncertainty and misperception amongst section 21 companies, it may we worth your while just put the matter beyond any doubt.

2.3. **Paragraph 2.4**

The issue of “welfare activities” and “normal activities” probably needs to be clarified a little more. Once registered as a vendor, “normal activities” can still be supplied for no consideration, in which case the value of the consideration would be regarded as “nil” in terms of section 10(23) of the VAT Act.

3. **CHAPTER THREE – Registering as a vendor**

3.1. **Paragraph 3.1**

3.1.1. The example in this paragraph refers to “any consideration that covers the cost of supplying the meals.” Section 17(2)(a)(i)(aa)(B) allows a deduction of input tax incurred if a charge equal to the open market value is made re the supply of the entertainment. Section 3(3) of the VAT Act defines *open market value* as “… the consideration in money which a similar supply would generally fetch if supplied in similar circumstances at that date in the Republic …”
3.1.2. The above raises the question of whether food aid provided by associations not for gain has any market value at all. Often any consideration charged by an association not for gain re feeding schemes, is merely a token consideration, but this is also the only amount that the recipients of the aid can afford. This raises the question of whether it could not be argued that the consideration charged is not in affect the market value of the supply as envisaged in section 3 of the VAT Act, as the circumstances under which the goods must be supplied in applying section 3 of the VAT Act must be similar to the circumstances in which the goods are actually supplied.

3.1.3. Careful consideration needs to be give to this issue as this is a very real issue faced by organisations on a daily basis.

3.2. Paragraph 3.2

3.2.1. We recommend that some guidance be given with regards to SARS’ interpretation of “maintains an independent accounting system …” In practice this often represents difficulties where one accounting system is kept, but where various cost centres are maintained in that system.

3.2.2. The use of one software package allows the user of the software licence to only pay for a single licence, whereas various licences would have to be paid for if a separate and independent accounting system has to be set up for each activity. It could also significantly increase the administrative costs associated with the operation and maintenance of the various systems.

3.2.3. We recommend that proper cost centre accounting be approved as fulfilling the requirement of having independent accounting systems as this will ensure operational efficiency and allowing these organisations to best utilise their scarce resources for the purpose they have been set up.

3.2.4. The example in this paragraph, on a pure technical level, we suggest that the reference to “dividend” be changed to “interest received” as technically a dividend received is not consideration received for any supply.

4. CHAPTER FOUR – Output and input tax

4.1. Paragraph 4.1

We refer to the sentence “Output tax must therefore typically be paid on the following supplies”. We recommend that the heading be changed to “Examples of supplies on which output tax is payable are.” Generally these organisations do not have very sophisticated accounting personnel, and they may interpret the current examples as an exhaustive list of taxable supplies (to the exclusion of everything else).
4.2. Paragraph 4.2

4.2.1. The issue of dealing with donations is causing huge confusion in welfare organisations and associations not for gain. With the greatest respect, we also believe that the relevant principles have been slightly confused in the Draft VAT 414.

4.2.2. In our opinion the basic principle is that donations do not constitute consideration as defined and as such any costs directly incurred in procuring such donations cannot be said to have been incurred in the course of making taxable supplies. This principle applies notwithstanding the fact that you are dealing with an association not for gain or a welfare organisation.

4.2.3. Also see further comments below re the treatment of donations in the apportionment methodology applied (comments on paragraph 4.3).

4.3. Paragraph 4.3

4.3.1. It would appear from the general context of the Draft VAT 414 that SARS accepts that where the apportionment percentage is computed on the turnover basis the value of donations should be excluded both in the nominator and denominator. We believe that this is the appropriate treatment for donations and apportionment computation purposes, as the donations merely serve to finance underlying expenditure incurred for the purpose of making taxable supplies, and are not consideration in their own right in respect of any supplies made.

4.3.2. We however suggest that this issue be dealt with more explicitly, and that the example used in paragraph 4.3 be extended to also show how the apportionment percentage would have been computed had the turnover method been applied (currently having used floor space as a basis).

4.3.3. As far as the specific example goes, we have the following comment:

- If SARS has approved a floor space method of apportionment, it must be applied to all expenditure relating to both taxable and other activities; this will include the food purchased (on the assumption food is not bought separately for the crèche and the feeding scheme). While it does not give the correct answer from an actual application/final consumption point of view, it would be the correct application of apportionment methodologies and VAT law as it currently stands. Unless a separate ruling is obtained from SARS to use actual measured consumption for food, the floor space method must also be applied to the food. The same principle applies to the pots acquired. We recommend that you give consideration on how you can address the potential confusion that may arise as a result of the current two-tier apportionment approach in the example.

- In our opinion that 35/100 split applied to compute the deductible portion of the smelting pot is the wrong ration to use. In our opinion it should be 35/85 (in other words the floor space used by the administrative part of
the business should be excluded from the denominator). The deficiency in the application of the current method can be demonstrated by computing the inverse of the current computation (i.e. computing the percentage non-deductible input tax and deduct that from the value of the smelting pot). In this case the percentage non-deductible input tax would be (based on the method used in the Draft VAT 414) 50% (50/100%). If the non-deductible portion of the smelting pot is 50%, then it can be deducted that the deductible portion is the balance (being 50% as well). In terms of the current application of the floor space method used in the Draft VAT 414, the deductible portion as only 35%. The reason for the discrepancy is the inclusion of the administrative floor space in the denominator. We recommend that this issue be considered to avoid unnecessary uncertainty.

Please do not hesitate to contact me should you require further information.

Yours faithfully

M Kendall CA(SA)
TECHNICAL ASSISTANT: TAX
The South African Institute of Chartered Accountants