VALUE ADDED TAX: CONSUMPTION AND UTILISATION

1. Background

1.1. Value Added Tax (VAT) is essentially a tax on consumption, although the basis of taxation in South Africa is triggered by invoicing. In addition South Africa uses the destination basis of taxation, i.e. VAT is levied at all stages of production and a credit is allowed as a necessary condition for ensuring that the final consumption is taxed. As a general principle the consumption/destination nature of VAT in South Africa is achieved by:

I. Taxing local supplies of goods and services at the standard rate of VAT;

II. Taxing exports of goods and services at the zero-rate;

III. Taxing the importation of goods at the standard rate; and

IV. Taxing the importation of services at the standard rate to the extent that such services are utilised or consumed within the Republic of South Africa for consumption, use or supply other than in the course of making taxable supplies.

1.2. In practice categories (I) to (III) do not represent significant interpretational difficulties, but the interpretation of the terms utilised or consumed in category (IV) is often the subject of very significant interpretational difficulties. This situation is exacerbated by the fact that neither of the terms utilised or consumed
are defined in the VAT Act No. 89 of 1991 (the VAT Act), nor are there specific place of supply rules contained in the South African VAT legislation.

1.3. Published Ruling Number 442 gave some guidance on the issue, but was amended with effect from 31 March 2006, essentially now stating the exact opposite from what the expressed view was previously.

1.4. The purpose of this submission is to put forward for your consideration some of the practical difficulties associated with the interpretation of the relevant terms. This will hopefully also assist SARS with some of the issues that will need to be considered in the drafting of place of supply rules as far as it relates to the supply of services.

2. The VAT Act

2.1. Section 7(1)(c) of the VAT Act imposes VAT on the supply of any imported services by any person.

2.2. *Imported services* is defined in section 1 of the VAT Act as a supply of services that is made by a supplier who is resident or carries on business outside the Republic to a recipient who is a resident of the Republic to the extent that such services are *utilised or consumed* in the Republic otherwise than for the purpose of making taxable supplies.

2.3. Section 14(2) of the VAT Act deems the time of supply of imported services to be at the earlier of issuing any invoice with regard to such supply, or the making of any payment.

2.4. The terms *utilised or consumed* are not defined in the VAT Act.

2.5. “*Consumed*” is defined in The Oxford Dictionary as “eat or drink; completely destroy; reduced to nothing or to tiny particles; engage the full attention of, engross, dominate; use up”.

2.6. *Utilised* is defined in The Oxford Concise Dictionary as “make practical use of; turn to account; use effectively”.

3. Interpretational difficulties

3.1. If regard is had to the above potential applications of the respective terms, it does not represent significant interpretational difficulties with regard to the supply of goods. When regard is had to the supply of services though (the nature of which inherently is incorporeal or intellectual), significant difficulties arise.

3.2. The term consumed as envisaged in the Oxford Concise Dictionary essentially means “used up; completely destroy; reduce to nothing or to tiny particles.” As far as this relates to services, it is submitted that the very nature of services is such that consumption coincides with the time that the services are supplied to the recipient. Once the services have been supplied, it is fully consumed by the
recipient. It is submitted that any benefit that may accrue to the recipient thereafter is a mere perception in the mind of the recipient (beauty lies in the eyes of the beholder). It is submitted that it cannot be held that services are consumed at any time subsequent to the supply thereof when some benefit is regarded as having been gained from it, but that consumption takes place at the time that the services are actually supplied.

3.3. An example of the above would be where two individuals attend an offshore seminar. The one individual finds the contents very interesting and decides to implement some of the ideas immediately on returning to South Africa. The other delegate decides that there is no value in the content of the seminar and goes back to work on a “business as usual” basis. To contend that the service received by delegate one was consumed in South Africa while those received by delegate two in the offshore country, would be illogical and out of touch with the reality of the nature of services. Based on the above we contend that the first guiding principle with regard to the consumption of services is that services are consumed at the time that the services are physically supplied.

3.4. The second principle for consideration is whether it could be said that such services are utilised in a different place than where the services are physically supplied.

3.5. If we accept the guiding principle that services are consumed when they are physically supplied to the recipient, it follows that utilisation must follow consumption (i.e. consumption must precede utilisation).

3.6. To utilise something means that it has to be used either immediately (in which case utilisation and consumption has the same meaning), or it is used over an extended period of time. When it comes to services, we submit that the general nature of services is such that no actual utilisation over a period of time takes place (any benefit accruing subsequent to the supply of the services would merely represent a perceived value in the hands of the original consumer of the services). Based on the above we accordingly submit that consumption and utilisation has to be given the same practical meaning and that both utilisation and consumption take place at the time that the service is rendered. It is therefore submitted that the second guiding principle to be applied is that both consumption and utilisation occurs at the time that a service is physically rendered. If this is indeed so, the further issue for consideration is then to question why the legislator used the term “utilised” in the first instance.

3.7. It is submitted that the term utilisation was included to determine the place of supply/taxing rights. It is submitted that a service can be physically rendered in one place, but be utilised in another (although utilisation and consumption takes place at the same time). It is submitted that to determine where a service is utilised, the real recipient/beneficiary of the service must be identified.

3.8. In this regard we submit that a distinction must be drawn between “personal services” (services supplied to an individual/company for their personal use) and services linked to some asset/commodity. Where services are rendered to a person/company (for example the supply of an opinion by a foreign solicitor from offshore), the services would be utilised in South Africa where the real recipient
of the services is located. If the services are however supplied directly in connection with property (moveable or immoveable), the real beneficiary of the services would be the property, which means that the services are both utilised and consumed offshore.

3.9. A practical example of the above would be where a South African resident services its motor vehicle in a neighbouring country. It is submitted that once the vehicle has been serviced, the service is fully consumed where it is physically supplied. To argue that the service has been consumed in South Africa would not be supported by the actual fact that the vehicle is physically still in the neighbouring country. It is submitted that at that point in time the services have clearly not “crossed the border.” If subsequent to the supply of the service the South African resident returns the vehicle to South Africa, it is submitted that it cannot be said that the service is now being utilised in South Africa; the benefit of the serviced vehicle is a mere expectation of better performance, a more reliable vehicle, etc. by the owner of the vehicle. The owner is not utilising the service, the service has already been fully consumed and utilised (the transforming of the vehicle into a potentially more reliable and well maintained tool). It is submitted that the time of supply rules contained in section 14(2) of the VAT Act supports this contention. The rule only makes provision for one supply (when an invoice is issued or any payment takes place). The relevant section does not require a continuous reassessment of the level of consumption in South Africa over the “useful period of the service”.

3.10. It is therefore submitted that the third guiding principle with regards to utilisation and consumption is that consumption and utilisation takes place as follows:

3.10.1. Where personal services are supplied to an individual/corporate entity – utilisation and consumption takes place where the individual/company is physically situated at the time that the services are rendered;

3.10.2. Where the services are supplied directly in connection with goods to the extent that the goods are beneficiated – consumption and utilisation take place where the goods are physically situated at the time of supply of the relevant services.

3.11. A final potential category of services that warrant attention are services that cannot specifically be categorised as either being consumed by an individual/company or a specific asset, due to the nature of such services. This category of services can potentially be classified as “passive services”, that is the supply of the services do not constitute an actual rendering of physical services. A common example of this category of services is offshore memberships of professional bodies. No actual services are provided to the members as a result of their membership, but such membership is often useful for local credentials. The actual service of being a member of a foreign professional body is however never “imported” in the sense that it can be said that it crosses the border. It is submitted that the only amicable and logical manner to treat such services is to regard consumption and utilisation to take place where the professional body is located.
4. **Summary of proposed guiding principles**

4.1. For the purposes of imported services, the terms *utilization* and *consumption* essentially have the same meaning.

4.2. For personal services, that is services where the real beneficiary is an individual or company, the services are utilised or consumed where the individual or company is situated at the time that the service is supplied;

4.3. For services where the real beneficiary is a identifiable asset, the services are utilized or consumed where the relevant asset is situated at the time that the service is supplied; and

4.4. In respect of “passive services” the services are utilized or consumed where the service provider is situated.

5. **Examples**

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<thead>
<tr>
<th>Transaction</th>
<th>Place of consumption and utilisation</th>
<th>Motivation</th>
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<tbody>
<tr>
<td>Attendance of seminars offshore</td>
<td>Where seminar takes place</td>
<td>This is a personal service – real beneficiaries are the delegates</td>
</tr>
<tr>
<td>Professional services – legal opinions</td>
<td>Where recipient of services is located</td>
<td>This is a personal service – real beneficiary is the recipient of the service</td>
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<tr>
<td>Short term Insurance</td>
<td>Where the insured is situated</td>
<td>This is a personal service – real beneficiary is the recipient of the service</td>
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<td>Servicing of vehicles/maintenance of other assets</td>
<td>Where assets are physically situated at the time that the services are supplied</td>
<td>This is a service directly linked to a specific asset – real beneficiaries are assets</td>
</tr>
<tr>
<td>Offshore membership of professional bodies</td>
<td>Where the professional body is situated</td>
<td>This is a passive service – service never crosses the border</td>
</tr>
<tr>
<td>Offshore portfolio management fees for the management of offshore cash</td>
<td>Where funds are physically situated</td>
<td>This is a service directly linked to a specific assets – real beneficiaries are assets</td>
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6. **Conclusion**

We recommend that the above principles be considered with a view of a broader discussion with your office in future to address the above issue and assist with future legislation that may be helpful in a self assessment environment.
Please do not hesitate to contact me should you require further information.

Yours faithfully

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