REPUBLIC OF SOUTH AFRICA

IN THE TAX COURT OF SOUTH AFRICA
(HELD AT MEGAWATT PARK, JOHANNESBURG)

(1)	REPORTABLE: YES/NO
(2)	OF INTEREST TO MANY JUDGES: YES/NO
(3)	REVISED.
SIGNATURE	DATE

CASE NO: VAT 1610

In the matter between:

ABC (PTY) LTD Appellant

and

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE Respondent

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JUDGMENT

LOUW, J

[1] This is an appeal by ABC (Pty) Ltd ("ABC") in terms of section 107 of the Tax Administration Act 28 of 2011 against tax assessments made by the South African Revenue Service ("SARS"). The appeal involves issues of law only, and in terms of section 118(3) of the Tax Administration Act 28 of 2011, the president of the court sitting alone must decide the appeal. The issues in dispute are whether ABC, when it determined its VAT liability for certain tax periods in 2012 in terms of the Value Added Tax Act 89 of 1991 ("the VAT Act"):

a. was entitled to the deduction, as input tax, of the VAT charged to it by local service providers when it substituted its foreign loans for loans from local banks; and

b. was obliged to declare and pay output VAT in respect of the fees paid to non-resident suppliers for their services in regard to the re-financing of the foreign loans.

[2] SARS issued additional assessments during July 2015 in which the claimed input tax was disallowed and output VAT was imposed in respect of the foreign services. ABC filed an objection to the assessments, but the objection was disallowed by SARS. ABC thereafter instituted the present appeal proceedings. If any of the additional assessments are upheld in the appeal, a further issue to be determined will be whether or not the consequential penalties imposed by SARS, which have been paid by ABC, will have to be remitted.

[3] The background facts, which are common cause and are recorded in the minutes of a pretrial conference held on 4 December 2018, can be summarised as follows:

a. On 11 April 2007, ABC Limited, which owned and operated a glass manufacturing business, concluded a written agreement with ABC in terms whereof ABC, which was a subsidiary of ABC Limited, purchased all the operations, assets and liabilities of ABC Limited and two of its subsidiaries for a purchase price of R5 921 726 490 as part of a re-organisation of the ABC group of companies. Following the completion of the transactions, ABC Limited held 75% of the ordinary share capital of ABC while the remaining 25% share capital was held by ABC Holdings Limited.

b. In order to finance the acquisition, ABC borrowed money from external funders by issuing Euro-denominated debt instruments (Eurobonds). Issuance is usually handled by an international syndicate of financial institutions on behalf of the borrower, one of which may underwrite the bond, thus guaranteeing the purchase of the entire issue. ABC was the issuer of 7⅝ of the First Priority Senior Secured Notes (the Eurobonds) which were due in 2014 and were guaranteed by ABC Holdings Limited and ABC Limited.

c. In terms of the offering memorandum submitted by ABC to the external funders, the net proceeds of the offering would be used, together with common equity contributions and funds received from a subordinated shareholder loan, to effect the re-organisation, to pay certain transaction costs relating to the offering, to repay certain debt amounts and to prepay certain capital expenditures.

d. Due to the fluctuation in the foreign exchange markets and the fluctuating value of the Rand, the cost of the funds was exposed to volatility. The reduction in the value of the Rand greatly increased the interest expense. In order to mitigate this risk to ABC, it acquired hedging instruments where possible. The cost of implementing these hedging instruments greatly increased the cost of business to ABC.

e. In 2012, ABC sourced competitive funding in the local market in order to reduce its costs. A decision was made to replace the Eurobonds with the finance sourced in the local market. As a result of this decision, a consortium of local banks, led by X Bank, provided funding to ABC of approximately R5 billion repayable over a period of 5 to 6 years.

f. ABC engaged foreign service providers, *inter alia* US Bank (London branch) ("US Bank") and M International Limited ("M Ltd") to assist it with the transactions. US Bank billed ABC for an *"administration fee" and* M Ltd billed ABC for *"professional services rendered for the period from 12 January 2012 through June 2012 relating to financing transactions and indenture compliance matters in respect of the 7⅝% First Priority Senior Secured Notes due 2014".*

g. To assist ABC with the re-financing transactions, ABC engaged N Attorneys which rendered a long list of services. J Attorneys billed Counsel for *"long-term transaction costs".* X Bank billed ABC for a *"Non-refundable Arranging Fee and Recoverable Expense Fee".* Z Bank billed it for a *"Non-refundable structuring fee"* and D Bank for a *"Structuring Fee"*. These local service providers all charged VAT for their services.

h. ABC deducted the VAT charged by these local service providers in its VAT submissions for the relevant periods in 2012. On 20 July 2015, SARS advised ABC that the deductions were disallowed and issued additional assessments for those VAT periods.

i. In regard to the services rendered by the foreign service providers, SARS issued assessments for payment of output tax on imported services not declared. In terms of the assessments, the total amount payable in respect of the disallowed VAT deductions and the output tax on imported services is R11 394 992.29.

THE FIRST ISSUE

[4] The first issue is whether SARS was entitled to disallow the input tax claimed by ABC on the fees charged by the local service providers for their assistance when ABC substituted its foreign loans with local loans.

[5] ABC contends that the VAT levied on these fees constitutes input tax because the fees were incurred to enable ABC to make taxable supplies. SARS contends that the expenditure on inputs and supplies in question was incurred for purposes of enabling ABC to make an exempt supply or supplies in the form of the issue of a debt security or securities. The argument is that, to the extent that an input is used or consumed in the course of or for purposes of making an exempt supply, as opposed to taxable supplies, there is no right to claim the input deduction.

[6] Section 7 of the VAT Act provides for the imposition of value-added tax. Section 7(1)(*a*) provides the following:

> "Subject to the exemptions, exceptions, deductions and adjustments provided for in this Act, there shall be levied and paid for the benefit of the National Reserve Fund a tax, to be known as the value-added tax—
>
> (*a*) on the supply by the vendor of goods or services supplied by him on or after the commencement date in the course or furtherance of any enterprise carried on by him."

[7] The relevant parts of the definition of *"enterprise"* in section 1 of the VAT Act read as follows:

> " 'Enterprise' means—
>
> (*a*) in the case of any vendor, any enterprise or activity which is carried on continuously or regularly by any person in the Republic or partly in the Republic and in the course or furtherance of which goods or services are supplied to any other person for a consideration, whether or not for profit, including any enterprise or activity carried on in the form of a commercial, financial, industrial, mining, farming, fishing, municipal or professional concern or any other concern of a continuing nature or in the form of an association or club.
>
> …
>
> Provided that—
>
> (i) anything done in connection with the commencement or termination of any such enterprise or activity shall be deemed to be done in the course or furtherance of that enterprise or activity;
>
> …

(v) any activity shall to the extent to which it involves the making of exempt supplies not be deemed to be the carrying on of an enterprise."

[8] The relevant parts of section 16(3) of the VAT Act provides the following:

"[T]he amount of tax payable in respect of a tax period, shall be calculated by deducting from the sum of the amounts of output tax of the vendor which are attributable to that period, as determined under subsection (4), … the following amounts, namely—

(*a*) in the case of a vendor who is in terms of section 15 required to account for tax payable on an invoice basis, the amounts of input tax—

(i) in respect of supplies of goods and services … made to the vendor during that tax period."

[9] The relevant part of the definition of *"input tax"* in section 1 of the VAT Act reads as follows:

" 'input tax', in relation to a vendor, means—

(*a*) tax charged under section 7 payable in terms of that section by—

(i) a supplier on the supply of goods or services made by that supplier to the vendor; or

(ii) the vendor on the importation of goods by the vendor;

(iii) the vendor under the provisions of section 7(3);

…

where the goods or services concerned are acquired by the vendor only for the purpose of consumption, use or supply in the course of making taxable supplies … ."

[10] *"Taxable supply"* is defined in section 1 to mean *"any supply of goods or services which is chargeable with tax under the provisions of section 7(1)(a), including tax chargeable at the rate of zero percent under section 11".*

[11] In *CSARS v De Beers Consolidated Mines Ltd,*[1] the following was said by Southwood AJA in para 51:

"The primary question requires that there be clarity as to the nature of the 'enterprise' because the purpose of acquiring the services and whether they were consumed or utilised in making 'taxable supplies' can only be determined in relation to a particular 'enterprise'. What the 'enterprise' consists of is a factual question. "

[1] [2012] 3 All SA 367 (SCA).

[12] Mr. T, the chief financial officer of ABC, testified that ABC manufactures and sells glass containers to, *inter alia,* the liquor, pharmaceutical and food industries. It is common cause that ABC acquired the business assets and liabilities from ABC Limited and two of its subsidiaries as going concerns during 2006 and that it thereafter continued operating the businesses. Mr. T testified that ABC needs equipment and other infrastructure to manufacture the glass containers. He explained the production process and the equipment used during that process. The furnaces which are used in the production process are hugely expensive. ABC requires a substantial amount of capital in order to obtain and maintain the furnaces and other infrastructure. This evidence was undisputed.

[13] SARS contends that the expenditure on the inputs and supplies incurred by ABC was to enable it to make an exempt supply or supplies in the form of the issue of a debt security or debt securities and that, to the extent that an input is used or consumed in the course of or for purposes of making an exempt supply, as opposed to taxable supplies, there is no right to claim the input deduction.

[14] Section 1 of the VAT Act defines *"exempt supply"* as *"a supply that is exempt from tax under section 12"*. The relevant part of section 12 reads as follows:

> "The supply of any of the following goods or services shall be exempt from tax imposed under section 7(1)(*a*):
>
> (*a*) The supply of any financial services, but excluding the supply of financial services which, but for this paragraph, would be charged with tax at the rate of zero per cent under section 11."

[15] In terms of section 2(1) of the VAT Act, certain activities are deemed to be financial services. One such activity is *"the issue, allotment, drawing, acceptance, endorsement or transfer of ownership of a debt security".*[2] A *"debt security"* is defined in section 2(2)(iii) to mean –

> "(*aa*) an interest in or right to be paid money; or
>
> (*bb*) an obligation or liability to pay money
>
> that is, or is to be, owing by any person, but does not include a cheque."

[16] It was contended on behalf of SARS that the evidence of Mr. T demonstrated that all the expenditure in issue in this appeal pertained directly to, and culminated in, ABC entering into a new debt finance agreement with a consortium of local banks, the proceeds of which were intended to be used to settle outstanding financial liabilities under the Eurobond issue and under hedging instruments separately entered into. SARS therefore contended that the

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2 Section 2(1)(*c*).

conclusion of the new debt-financed agreements in 2012 amounted to the *"issue"* by ABC of a *"debt security"* as defined.

[17] It is common cause between the parties that the services that were rendered to ABC by the local service providers, and on which they levied VAT, are those set out in the list annexed to this judgment, marked "A". The structuring fees payable to X Bank, Z Bank and D Bank are, according to Mr. T, standard fees which are payable to a bank in order to arrange finance. The agreement fee paid to X Bank was paid in order for it to obtain the loan from the three banks. The fees paid to J Attorneys were for the drafting of the agreements and the fees paid to N Attorneys were for professional advice in respect of the obtaining of the local financing. Although these services were rendered in connection with ABC's application to the consortium of local banks for a loan, they were not the making of the loan itself for which ABC would have had to, in the words of the VAT Act, issue a debt security or securities to the banks. ABC did not issue a debt security in respect of the services which were rendered by the service providers.

[18] Whether ABC was entitled to deduct the VAT charged by the local service providers as input tax, will, however, depend on whether the services concerned were acquired *"wholly for the purpose of consumption, use or supply in the course of making taxable supplies"* as is required in terms of the definition of *"input tax"* in section 1 of the VAT Act.

[19] It is common cause that the funds raised by the issue of the Eurobonds were applied for the purposes set out in ABC's offering memorandum in respect of the Eurobonds. A copy of the relevant page of the offering memorandum is annexed to this judgment, marked "B". In respect of the *"reorganisation"* referred to therein, the following is stated on p. 29 of the offering memorandum:

> "Upon the scheme becoming operative, the issuer (ABC) will acquire ABC (Limited's) business, including the operations, assets and liabilities of ABC (Limited) and its operating subsidiaries (the 'reorganisation')."

[20] Mr. T testified that, in terms of the reorganisation, ABC acquired the businesses, including the assets, properties, stock and employees of ABC Limited and its subsidiaries FG (Pty) Ltd and HI (Pty) Ltd. The purchase price for ABC Limited's assets and business as a going concern was R5 921 726 490 plus the face value of the included liabilities which amounted to R418 314 000. The acquisition was financed with the proceeds of the Eurobonds. On acquiring the businesses, ABC continued the manufacture and sale of glass containers which was previously done by the three entities.

[21] The first redemption date of the Eurobonds was 15 April 2014. It is common cause that the Eurobonds were redeemed in 2012. Mr. T said that the cost of the long term foreign debt proved to be expensive because of the fluctuation in the value of the Rand and the cost of hedging the debt which had become necessary to counter the volatility in the exchange rates. In 2012, interest rates locally had dropped and local financing became more cost-effective. This was the motivation to redeem the Eurobonds earlier. The substitution of the Eurobonds with local financing greatly reduced ABC's costs and made it more competitive.

[22] Counsel for SARS submitted that, even if it is found that ABC did not utilise or consume the supplies (i.e. the services of the local service providers) for purposes of making an exempt supply of financial services in the form of the issue of a debt security, the supplies were not utilised or consumed by ABC *"in the course of making taxable supplies"* as is required in the definition of *"input tax"* in section 1 of the VAT Act. Counsel referred in this regard to the judgment of Conradie J in ITC 1744.[3] In that matter, the taxpayer (the appellant) needed to raise capital for manufacturing shipping containers. It set about raising the capital by employing the services of A, a company specialising in the venture capital market. In the tax year in question, A undertook two share placings for the appellant and received as remuneration for its services 20% of the capital raised. It paid SARS and in turn recovered from the appellant VAT on its remuneration.

[23] The issue, allotment and transfer of shares are deemed to be financial services in terms of section 2(1) of the VAT Act. The taxpayer, however, sought to deduct the VAT on the basis that it amounted to input tax. The deduction was disallowed by SARS. The appellant's case was that although the supply of financial services is exempt from VAT, its claim for input tax should, exceptionally, be allowed because of the close connection between the sale of the shares and the containers manufactured by it, which would not have been manufactured if the capital had not been raised by the company. Conradie J said that the difficulty with the submission was that

> "although the raising of the capital might have been indispensable to the making of the taxable supplies, one would, if [counsel for the appellant] were right, have to interpret the expression 'in the course of the making of taxable supplies' to accommodate the remuneration paid for the raising of the appellant's capital. The raising of capital seems a rather to be preparatory to the making of the taxable supplies. It does not seem to me that one can reasonably say that A's services were acquired in the course of manufacturing the shipping containers. Capital goods such as machinery board with the raised capital can be said to have been acquired in the course of making taxable supplies. But there the connection is closer. And it is the closeness of the connection that counts".

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3 65 SATC 154.

[24] The court concluded, relying on the judgment of the European Court of Justice in *BLP Group plc v Commissioners of Customs and Excise (European Court Reports p I – 0983)*, that the principle is that where goods or services are used for an exempt supply it is not legitimate for the taxpayer to look through that supply to an ultimate purpose of carrying out taxable supplies.

[25] In my view, the same principle applies in the present matter. There is an insufficiently close link between the services acquired from the local service providers and the making of taxable supplies. The services were not acquired *"wholly for the purpose of consumption, use or supply in the course of making taxable supplies".* The purpose of the loans obtained from the local banks, and in respect of which the services in question were acquired, was not for the purpose of making taxable supplies. Their purpose was recorded as follows in paragraph 5 the Common Terms Agreement which ABC concluded with the banks:

> "**PURPOSE**
>
> 5.1 Purpose
>
> 5.1.1 The Borrower that shall apply each Loan borrowed by it under the Senior Terms Facilities:
>
> 5.1.1.1 first, towards refinancing the Existing Indebtedness in accordance with the flow of Funds Agreement;
>
> 5.1.1.2 thereafter to paying the Transaction Costs; and
>
> 5.1.1.3 towards funding the repayment of shareholder loans owing by the Borrower to the Parent in an amount equal to the Distributable Amount; and
>
> 5.1.1.4 towards funding general corporate and working capital requirements of the Group with any amount remaining after making the payments set out in Clauses 5.1.1.1 to 5.1.1.3 above.
>
> 5.1.2 The Borrower shall apply any utilisation of any Working Capital Facility towards the general corporate and working capital purposes of the Group (but not towards acquisitions of companies, businesses or undertakings, the payment of the Distributable Amount or prepayment of any Senior Term Facility).

[26] It follows that ABC was not entitled to deduct the VAT charged by the local service providers and that SARS was entitled to disallow the deduction.

SECOND ISSUE

[27] The second issue is whether ABC was obliged to declare and pay output VAT in respect of the fees paid to non-resident suppliers for their services in regard to the re-financing of the foreign loans.

[28] In terms of section 7(1)(*c*) of the VAT Act, VAT is payable on the supply of any imported services by any person. SARS contends that the services rendered by US Bank, M Ltd and K Co. constitute imported services in respect of which ABC was obliged to pay input tax. ABC contends that the services were acquired in order for it to make taxable supplies and that they are therefore not *"imported services"* for purposes of section 7(1)(*c*).

[29] *"Imported services"* is defined in section 1 of the VAT Act to mean:

> "A supply of services that is made by a supplier who is a 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 utilized or consumed in the Republic otherwise than for the purpose of making taxable supplies."

[30] In terms sub-section (*a*)(ii) of the definition of *"input tax"* in section 1, VAT charged under section 7 is payable in terms of that section by the vendor on the importation of goods by that vendor "*where goods or services concerned are acquired by the vendor wholly for the purpose of consumption, use or supply in the course of making taxable supplies ….".* The requirement is therefore similar to the requirement in respect of input tax payable on the supply of goods or services by a supplier to a vendor. The services rendered by the foreign service providers will therefore only constitute imported services if those services were not utilised by ABC for the purpose of making taxable supplies.

[31] Mr. T testified that the services rendered by M Ltd were in respect of how to execute on the redemption of the Eurobonds. He testified that the services rendered by US Bank related to the redemption of the Eurobonds and that the services rendered by K Co. were for the unwinding of the hedging instruments.

[32] The reasoning which led to the conclusion to which I came in respect of the first issue applies *mutatis mutandis* to the second issue. There is no distinction between the nature of the services provided by the local service providers and those provided by the foreign service providers. It therefore follows that ABC was obliged to pay output tax on the fees charged by the foreign service providers.

THE THIRD ISSUE

[33] The final issue, if the appeal on the merits fails, involves the imposition by SARS of a 10% non-payment penalty.

[34] ABC contends that, in the event that the first and second issues are found against it, the 10% penalty imposed by SARS should be remitted as there was no intent not to make payment or to postpone payment which would justify the imposition of the penalty.

[35] Section 39(7)(*b*) of the VAT Act, prior to 1 October 2012 provided the following:

> "Where the Commissioner is satisfied that the failure on the part of the person concerned or any other person under the control or acting on behalf of that person to make payment of the tax with in the period for payment contemplated in subsection …—
>
> (*a*) …
>
> (*b*) was not due to an intent not to make payment or to postpone liability for the payment of the tax, he or she may remit, in whole or in part, any penalty payable in terms of this section."

[36] The VAT in respect of which the assessments were raised, were prior to 1 October 2012, except for the last October 2012, which is subject to the Tax Administration Act 28 of 2011. It was not contended on behalf of SARS that ABC had the intent not to make payment or to postpone liability for the payment of the tax. The penalty which was imposed, should therefore be remitted.

COSTS

[37] It was not contended by SARS that ABC acted unreasonably in pursuing the appeal. It therefore did not seek any order for costs against ABC and proposed that no order is to costs should be made.

ORDER

I make the following order:

1. The appeal is dismissed.
2. The additional assessments raised by the Commissioner for the tax periods 04/2012, 06/2012, 07/2012, 08/2012 and 10/2012 are confirmed.
3. The Commissioner is ordered to remit the penalty which has been imposed.
4. No order is made as to costs.

J W LOUW

PRESIDENT OF THE TAX COURT