

INTERPRETATION NOTE: NO. 70

DATE: 14 March 2013

ACT : VALUE-ADDED TAX ACT NO. 89 OF 1991 (the VAT Act)
SECTION : SECTION 1(1) DEFINITION OF THE TERMS “ENTERPRISE”, “TAXABLE SUPPLY”, “INPUT TAX”, “DONATION” AND “CONSIDERATION” SECTIONS 10(4) AND 10(23)
SUBJECT : SUPPLIES MADE FOR NO CONSIDERATION

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Preamble

In this Note references to “**sections**” are to sections of the VAT Act unless otherwise stated and any word or expression bears the meaning ascribed to it in the VAT Act.

1. Purpose

This Note serves to –

- set out the legal framework for the VAT treatment of supplies of goods or services which are made by vendors for no consideration in certain circumstances; and
- provide guidance to vendors, on whether –
 - input tax may be deducted in respect of any VAT incurred on goods or services acquired to make supplies for no consideration; and
 - output tax must be declared on any goods or services supplied for no consideration.

2. Background

The definition of “enterprise” in section 1(1) is one of the most important definitions in the VAT Act. Its main purpose is to set out as clearly as possible, the type of persons, activities and supplies which are intended to form part of the tax base, as well as those that are meant to be excluded. In terms of paragraph (a) of this definition, there is a general requirement that enterprises participating in the VAT system must charge a consideration (price) for the goods or services they supply.

The implication of not meeting this requirement is that supplies made for no consideration are not made in the course or furtherance of an enterprise, and hence, will not be a taxable supply. However, there are many different circumstances under which enterprises will, for purely commercial reasons, make a supply without charging a consideration.

This raises the question as to whether there are certain circumstances under which a supply for no consideration may be regarded as a taxable supply, and consequently, whether it will be possible for the supplier to deduct input tax on any expenses¹ incurred for the purpose of making those supplies.

¹ Any reference to “expenses” in this Note in the context of considering whether input tax is deductible or not, is assumed to include VAT at the standard rate unless otherwise indicated.

The ability to correctly characterise a particular supply as being taxable or not is important because the vendor will generally have a right to deduct the VAT incurred on any goods or services acquired for the purposes of making taxable supplies, but will not be able to do so if the supplies are exempt, out-of-scope, or in connection with any other non-taxable activities conducted by the vendor.

To fully understand the VAT treatment of supplies made for no consideration under the South African VAT system, it is necessary to understand the underlying policy framework which influences the design of the VAT system, as well as the general international characteristics and principles upon which a VAT system of taxation is based. This is important because although the different countries that have VAT (or goods and services tax (GST) as it is known in some other countries) have very similar core features, there are often a number of differences in the detail of how the features and designs of those systems apply.

The approach of this Note is therefore to set out the framework in **3** below, of some of the international principles and characteristics of VAT which affects the legislative design of a VAT system in general before dealing with the treatment of these supplies under the South African VAT system in **5**. Refer also to **Annexure C** which includes a number of extracts from the VATCOM Report² setting out the original policy framework of VAT in South Africa, particularly as it relates to associations not for gain and welfare organisations.³ Readers who are already familiar with the principles and concepts dealt with in **3** should proceed to the wording of the relevant provisions of the VAT Act in **Annexure A**, or the interpretation of those provisions in **5**.

3. International characteristics and principles of VAT

3.1 Tax policy and legislative design

The main purpose of VAT⁴ is to raise revenue for government. VAT legislation requires any person that conducts taxable activities⁵ exceeding the prescribed registration threshold value to register with the tax authorities as a vendor⁶ and to collect and pay VAT on the consideration received for taxable supplies of goods or services made by the enterprise.⁷ Generally, in a broad-based tax such as VAT, concessions and exceptions are kept to a minimum so as not to erode the tax base and its potential to generate revenue.

South Africa applies the invoice-based credit method of VAT (also known as the subtraction method) which is used in most other countries. Under this method, credit is granted for the VAT incurred on taxable enterprise inputs (input tax) which may be subtracted from the tax collected on taxable supplies made (output tax). The VAT payable by the vendor to the tax authorities is the difference between the output tax

² The Value-Added Tax Committee (VATCOM) was a committee consisting of members from the private and public sectors, appointed by the Minister to consider the comments and representations made by interested parties in 1991 before VAT was introduced.

³ Although there have been a number of amendments to the VAT Act over the years, the policy framework has essentially remained unchanged since the introduction of VAT in 1991.

⁴ For ease of reading, in **3** of the Note, which deals with international VAT and GST principles, any reference to the acronym "VAT" includes reference to the acronym "GST" which may be used in other countries as a national tax that embodies the basic features of a value-added tax.

⁵ This is commonly referred to as a "business" or "enterprise".

⁶ Alternative terms used in some countries include "taxable person" or "registered person".

⁷ In some countries reference is made to a "business" or a person that conducts "economic activities".

and the input tax in any particular tax period. In a situation where input tax exceeds output tax in a tax period, the vendor is entitled to a refund of the difference. As refunds may be a regular feature of certain businesses,⁸ this aspect is incorporated into the mechanics and design features of the VAT legislation.

In any VAT system, the tax base consists mainly of persons that conduct commercial activities which usually have a profit motive,⁹ but it also includes the activities of entities that are not necessarily focused on profitability. The underlying assumption is that most businesses are carried on for the purpose of making a profit on an ongoing basis, and will usually be in a net VAT payable situation, thus generating the required revenue. This is despite the fact that certain vendors participating in the VAT system may be entitled to refunds on a regular basis.

3.2 General principles and guidelines

In terms of the guidelines¹⁰ issued by the Organisation for Economic Co-Operation and Development (OECD), a VAT is considered to have the following general characteristics:

- It is a tax on consumption, paid, ultimately, by final consumers.
- The tax is levied on a broad base;
- In principle, business should not bear the burden of the tax itself since there are mechanisms in place that allow for a refund of the tax levied on intermediate transactions between firms.
- The system is based on tax collection in a staged process, with successive taxpayers entitled to deduct input tax on purchases and account for output tax on sales. Each business in the supply chain takes part in the process of controlling and collecting the tax, remitting the proportion of tax corresponding to its margin, that is, on the difference between the VAT paid out to suppliers and the VAT charged to customers.

In general, OECD countries with value-added taxes impose the tax at all stages and normally allow immediate deduction of taxes on purchases by all but the final consumer.¹¹

⁸ Examples include exporters and other suppliers which mainly make supplies which are subject to VAT at the zero rate.

⁹ The absence of a profit motive will usually not be grounds to exclude the person from being required to register with the tax authorities and to account for VAT. There may, however, be special rules which apply in certain cases.

¹⁰ “*International VAT/GST Guidelines*” – February 2006 – published by the OECD Centre for Tax Policy and Administration. It should be noted, however, that these are only broad guidelines and do not cover every aspect of VAT. For example, there is no specific guideline on the treatment of supplies made for no consideration. The guidelines were also published for comment together with other draft policy documents in a consolidated form in February 2013 as “*OECD International VAT/GST Guidelines – Draft Consolidated version*”.

¹¹ An additional principle mentioned later in the OECD guidelines, is that, except where explicitly provided for in the design and general functioning of the VAT or GST, when activities or supplies are explicitly exempted (e.g. financial services), or which are out-of-scope, the tax burden should not lie on taxable business but on the final consumer.

A further description offered by the Directorate General for Taxation¹² of the European Community is as follows:

“Value added tax is

- a general tax that applies, in principle, to all commercial activities involving the production and distribution of goods and the provision of services.
- a consumption tax because it is borne ultimately by the final consumer. It is not a charge on businesses.
- charged as a percentage of price, which means that the actual tax burden is visible at each stage in the production and distribution chain.
- collected fractionally, via a system of partial payments whereby vendors (i.e., VAT-registered businesses) deduct from the VAT they have collected the amount of tax they have paid to other vendors on purchases for their business activities. This mechanism ensures that the tax is neutral regardless of how many transactions are involved.
- paid to the revenue authorities by the seller of the goods, who is the "vendor", but it is actually paid by the buyer to the seller as part of the price. It is thus an indirect tax.”

Whilst there may be differences in the detail of how different countries describe their VAT systems, it is evident that there are striking similarities in their core features.¹³ The OECD in paragraph 5 of the preface to its International VAT/GST Guidelines (February 2006) has the following to say in this regard:

“Nevertheless, although most countries have adopted similar principles for the operation of their value added tax system, there remain many differences in the way it is implemented, including between OECD member countries. These differences result not only from the continued existence of exemptions and special arrangements to meet specific policy objectives, but also from differences of approaches in the definition of the jurisdiction of consumption and therefore of taxation. In addition, there are a number of variations in the application of value added taxes, and other consumption taxes, including different interpretation of the same or similar concepts; different approaches to time of supply and its interaction with place of supply; different definitions of services and intangibles and inconsistent treatment of mixed supplies.”¹⁴

Although VAT legislation is generally broad-based and embraces all types of commercial activities, it does not include all activities of all entities in the economy. This distinction is achieved by the use of definitions or specific legislative provisions which modify the effect of the broad-based definitions which describe the activities or entities which are intended to fall within the tax base.

The effect of these “carve-outs” or modifiers, is that non-taxable activities such as those in the public domain, or those which are regarded as private, *ad hoc*, out-of-scope or exempt, are specifically identified, characterised and appropriately dealt with in the legislation. The idea being to make it clear under which circumstances

¹² For more information, visit the website of the Directorate General for Taxation of the European Community http://ec.europa.eu/taxation_customs/index_en.htm.

¹³ The discussion in this Note is restricted to the invoice-based credit method of the consumption-type VAT as this is the type used in the Republic and in most other countries.

¹⁴ The term “mixed supplies” refers to a situation where the VAT-registered person (vendor) makes both taxable and non-taxable supplies. When the VAT on taxable acquisitions is incurred for both taxable and non-taxable (mixed) purposes the vendor is required to make an apportionment so that only a portion of the VAT may be deducted as input tax.

certain supplies are to be regarded as taxable and when they should not. It is also expected that when vendors make both taxable and non-taxable supplies, the associated expenses for each type of supply should be appropriately attributed to the particular activities to which they relate. Where possible, the expense should be directly or wholly attributed to taxable or non-taxable purposes. Where this is not possible, an apportionment of those expenses must be made, and only the part that relates to the taxable activities may be deducted.

It is within this context that some of the main principles and features of an invoice-based credit method of the consumption-type VAT are discussed below. The discussion is limited to those aspects which concern supplies made for no consideration. The application of the general international principles set out in **3.3** provide the framework and context within which the South African approach on this topic is discussed in the rest of this Note.

3.3 Supplies made for no consideration

One aspect of VAT that is sometimes overlooked is that, as a general requirement, enterprises participating in the VAT system must charge a consideration¹⁵ (price) for the goods or services they supply. The implication is that to the extent that the activity involves the making of supplies for no consideration, the person conducting those activities will not be entitled (or required) to register as a vendor unless the VAT legislation provides otherwise.¹⁶ If the person also conducts taxable business activities, that person may be liable to register and the normal VAT rules will apply. Consequently, to the extent that expenses are incurred for non-taxable purposes, no input tax may be deducted. In these situations, it is incorrect to conclude that because there is a liability to register for taxable supplies made, that the person's non-taxable activities are now re-characterised so as to become taxable. Rather, the liability to register and account for VAT on transactions is limited to the extent that taxable activities are carried on.

An analysis of the principles and characteristics set out above, as well as the legislation and explanatory information published by various tax authorities on how their VAT systems operate, reveals that there is a great deal of inconsistency in the VAT treatment of supplies made for no consideration. For example, in Australia, certain religious activities are GST-free (equivalent to the zero rate of VAT), whereas in Ireland those same activities are exempt. Many countries, including South Africa, take the view that, generally, the activities of religious, political, philanthropic and other organisations of an altruistic nature are not conducted in the manner of a business or enterprise. This is based on the view that such organisations are mainly engaged in making non-taxable supplies for no consideration. As such, the supplies are either dealt with in terms of an exemption or are regarded as being outside the scope of VAT. Until recently, the South African VAT legislation did not have any

¹⁵ The consideration may be monetary or non-monetary.

¹⁶ A South African example of this exception is paragraph (b)(ii) of the definition of "enterprise". This provision is specifically intended to allow a welfare organisation that carries on welfare activities to qualify as an enterprise. This gives effect to the tax policy that specific relief should be provided within the VAT system to welfare organisations. The provision was therefore necessary as welfare organisations typically make supplies for no consideration and their activities would not otherwise qualify as "enterprise" activities under paragraph (a) of the definition of "enterprise". This concept is discussed in more detail in **5.1.1 and 5.2.9 to 5.2.11**.

specific exemptions in this regard,¹⁷ but whether such non-taxable supplies are treated as out-of-scope or exempt for VAT purposes, the same result is achieved.¹⁸

Whilst such organisations may engage primarily in non-taxable activities, it is recognised that they may also conduct business or businesslike activities in an organised manner. To the extent that this involves the making of supplies for a consideration, the normal VAT rules will apply.¹⁹ This means that the VAT treatment of supplies and expenses which are incurred in order to make supplies for no consideration could be different, based on the facts and circumstances of the case. For example, promotional supplies such as product samples made for no consideration in a business (commercial) context are generally regarded as taxable supplies if they are made in an effort to promote other taxable supplies which are usually made for a consideration by the enterprise.²⁰ On the other hand, expenses incurred for the purpose of making supplies for no consideration in the context of promoting a particular religion may not be deducted as input tax because of the non-taxable nature of the activities to which they relate.

It follows that, in determining whether the making of supplies for no consideration is a taxable supply, it must be clear that the activities which gave rise to the supply are conducted in the course or furtherance of the business or enterprise activities. Furthermore, it must be established whether a nil value can be accepted as the value of supply, or if a special value of supply rule or deeming provision prescribes another value.

Similarly, before any deduction of the VAT incurred to make the supplies for no consideration can be allowed as input tax, it must be clear that the purpose for which those expenses were incurred is indeed for purposes of use, consumption or supply in the course of making taxable supplies. In other words, no input tax will be allowed if the expenses are incurred wholly in the course of conducting exempt, out-of-scope or other non-taxable activities. If the expenses were incurred for mixed purposes, only a portion of the VAT incurred may be deducted as input tax.

¹⁷ Refer to section 147(1)(b) of the Taxation Laws Amendment Act 22 of 2012 which was promulgated on 1 February 2013. In terms of these amendments, new exemptions in the form of sections 12(l) and (m) were introduced for bargaining councils established in terms of section 27 of the Labour Relations Act, 1995 and political parties registered in terms of section 15 of the Electoral Commission Act, 1996 respectively. The exemptions are limited to the extent that any goods or services are supplied to any of the respective members of those organisations, when the consideration for the supply consists of membership contributions. The exemptions apply with effect from 1 January 2013, but relief was also provided under section 40C in regard to transactions before that date.

¹⁸ Exempt supplies and out-of-scope supplies are basically the same as no input tax may be deducted and no output tax must be declared in regard to any supplies made. However, in some countries, there may be a difference. For example, some countries allow certain organisations (e.g. “charities”) to claim a refund of VAT incurred on their activities, notwithstanding the fact that expenses were incurred in the course of making non-taxable supplies. In South Africa, this approach is not adopted, although special treatment is afforded to welfare organisations that carry on “welfare activities”. This topic is discussed later in the Note.

¹⁹ The exception is where an exemption is provided for the entity itself or for specific activities carried on by those entities.

²⁰ There is still some degree of inconsistency regarding the details of how this rule is applied among the various countries. For example, in some countries, input tax is denied in regard to the manufacture and distribution of free samples of products which are taxable. Refer for example to **5.1.5, 5.1.6, 5.2.2 and 5.2.3.**

A distinction must also be drawn between supplies made for no consideration and a situation where no supplies are made at all.²¹

Unlike the inconsistency among the various countries in the VAT treatment of supplies made for no consideration, there is a much greater degree of alignment when it comes to the principles and right to deduct input tax under a VAT system of taxation.

The general principles of input tax are as follows:

- Input tax may be deducted from the output tax liability only to the extent that the VAT is incurred for the purpose of use, consumption or supply in making taxable supplies (that is, supplies which are in the course of carrying on business/enterprise activities).
- No input tax deduction is available where VAT is incurred for making exempt supplies or for other non-business/non-enterprise purposes.
- If a person only conducts activities which do not result in any supplies being made to another person for a consideration, the person conducting those activities may not register for VAT or deduct input tax. For example, when conducting a hobby, or merely holding shares as an investment.
- When VAT is incurred both for enterprise and non-enterprise purposes, an apportionment of input tax must be made, and only the part that relates to the taxable business activities may be deducted. For example, input tax in respect of general overheads²² such as audit fees, advertising, rent, telephone and stationery for a business that makes both taxable and non-taxable supplies may only be deducted to the extent that they can be attributed to the taxable part of the business.
- Typically, input tax is specifically denied for certain goods or services acquired, where there is a risk of abuse, or a possibility of a substantial element of private consumption, for example, entertainment and passenger vehicles.

4. The law

For ease of reference, the relevant sections of the VAT Act are quoted in **Annexure A**.

²¹ An example is where a person merely holds the shares of a company as an investment so that no supplies are made to any other person. Any VAT incurred in holding such shares cannot qualify as "input tax".

²² Note that the classification of expenses as being of a "general" nature from an accounting perspective by an enterprise that makes both taxable and non-taxable supplies does not necessarily mean that the expense will be apportioned for VAT purposes. When considering if input tax may be deducted, the **actual purpose** of the acquisition must still be established. Certain expenses may, on the face of it, appear to be of a general nature, but these might turn out to be incurred specifically for taxable or non-taxable purposes and not for mixed purposes. For example, in the case of the *Commissioner: South African Revenue Service vs De Beers Consolidated Mines Limited* (503/11) 2012 ZASCA 103 (the *De Beers* case) it was held that certain expenses related to a complicated share transaction were not part of the general overheads of its mining enterprise for VAT purposes. Instead, the court ruled that the expenses were wholly incurred for **specific purposes** relating to the share transaction, and that this was not a taxable purpose. Consequently, the vendor could not deduct any input tax in that regard.

5. Application of the law

5.1 Definitions, concepts and valuation rules

5.1.1 Definition of “enterprise” [section 1(1)]

General rules – paragraph (a)

The concept of an enterprise is central to VAT. Registration is required (or available on a voluntary basis) only when a person carries on, or intends to carry on, an “enterprise” as defined. VAT must be charged only on taxable supplies which are made in the course or furtherance of an “enterprise” and “input tax” may only be deducted to the extent that VAT is incurred for the purpose of making taxable supplies. Paragraph (a) of the definition contains the general test for an enterprise and refers to any business activity in the broadest sense and reads as follows:

“(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;”

As a general interpretation matter, the wording that follows the word “including...” in paragraph (a) is illustrative of the words that precede it, and does not indicate that two separate categories of “enterprise” are envisaged.²³

For the purposes of this Note, the wording of paragraph (a) can be summarised as any enterprise or activity carried on –

- continuously or regularly;
- by any person;
- in or partly in the Republic;
- in the course of which goods or services are **supplied for a consideration** (that is, some form of payment);
- whether or not for profit.

Specifically included in paragraph (a) are the activities of municipalities,²⁴ clubs and associations. Public entities that are listed in Schedule 2 and Parts B and D to Schedule 3 of the Public Finance Management Act, 1999 (the PFMA) are also treated as normal businesses under this paragraph.

²³ Refer to paragraph 36 of the judgment in the *De Beers* case. In this case, the appellant argued that there were two categories of enterprise encapsulated in paragraph (a) of the definition. The first being the part which concludes with the word “profit”, and the second, that part commencing with the word “including”. It was argued that once a vendor falls within the ambit of the definition of an “enterprise” (regardless of whether in the first or second category), any activity whatsoever of that enterprise forms an integral part and parcel of the enterprise, unless it is excluded in terms of proviso (v) of the definition. This interpretation was found to be incorrect.

²⁴ From 1 July 2006, paragraph (a) specifically includes the activities of municipalities which, before that date, were dealt with in terms of the now deleted paragraph (c) of the definition. For more information in this regard, refer to **5.2.7** as well as the *VAT 419 - Guide for Municipalities*.

Provisos (i) to (x) to the definition clarify whether certain activities are regarded as being in the course or furtherance of an enterprise or not. For example, anything done in connection with the commencement or termination of an enterprise is carried out in the course or furtherance of an enterprise, but the following are examples of supplies and activities which are excluded:

- Services rendered by an employee to an employer and in respect of which remuneration is earned. This must, however, be distinguished from an independent contractor that charges a fee for services rendered.
- Supplies by a branch or main business permanently located outside the Republic which is separately identifiable from the business in the Republic and has its own independent system of accounting.
- Private or recreational pursuits or hobbies (unless carried on in the form of a business/enterprise), including the occasional sale of household goods or personal assets.
- Supplies made by a constitutional institution listed in Schedule 1 to the PFMA.
- Exempt supplies.

In addition, the VAT Act contains deeming provisions (mainly in section 8) which will deem certain transactions to be taxable supplies, or certain receipts to be in respect of taxable supplies made by a vendor, and as such, will be carried on in the course or furtherance of the vendor's enterprise. For example; the deemed supply of enterprise assets upon ceasing to be a vendor; certain fringe benefits supplied to employees; and the private, exempt, or other non-taxable use of enterprise assets.

“activity or enterprise”

Paragraph (a) refers to an “activity or enterprise”. The use of the words “activity or enterprise” makes the definition very wide so that most activities (unless specifically excluded) will constitute an “enterprise”. The term “enterprise” when used as part of the wording of the definition of that same term, means that the ordinary meaning of that word will apply in that context. The terms “activity” and “enterprise” are defined as follows according to the Encarta Dictionary (English UK):

“ **[A]ctivity**’ means:

1. something somebody does – something that somebody takes part in or does
2. ...
3. state of doing something – the state or process of doing something or being active.”

“ **‘enterprise’** means:

1. commercial business – a commercial company
2. business activities directed at profit – organized business activities aimed specifically at growth and profit
3. daring new project – a new, often risky, venture that involves confidence and initiative
4. readiness to undertake new ventures – readiness to put effort into new, often risky, ventures or activities.”

The phrase “activity or enterprise” provides the main context within which the other words used in the term “enterprise” as defined in the VAT Act are to be interpreted, and essentially provides an **activity-based test**. Further, it refers to the kind of activities which are carried out in a commercial context where goods or services are

supplied for a consideration. Typically, this refers to a business or similar venture, conducted in an organised and businesslike manner, where an element of risk-taking is involved, and where the aim is to grow or make a profit²⁵ or to ensure that the organisation's activities are sustainable. Most countries will either have the term "enterprise" or "business" defined for the purpose of describing their tax base or the context in which VAT will apply to transactions. For this reason, as well as the fact that the term "business" appears in the definition of the ordinary meaning of an "enterprise", it is useful to consider the ordinary meaning of a "business" within this context.

The Encarta Dictionary (English UK) defines the term "business" as follows:

“ **[B]usiness**’ means

1. line of work – a particular trade or profession
2. commercial organisation – a company or other organisation that buys and sells goods, makes products, or provides services
3. commercial activity – commercial activity involving the exchange of money for goods or services.”

It becomes clear, when considering these terms and definitions, that in the context of supplies which are made for no consideration, the supplies can only be regarded as taxable if they are made in the context of a "business"²⁶/ "enterprise" activity. Further, that there should be an integral connection between the supplies made for no consideration and the activities involving the supply of goods or services in return for some form of payment.

For example, in the *De Beers* case, the VAT implications of a complex share transaction involving a corporate restructuring undertaken by the vendor were considered by the Supreme Court of Appeal (SCA). The appellant's view, which was initially confirmed in the Tax Court,²⁷ was that these activities were conducted in the course or furtherance of its enterprise. However, the SCA found this to be incorrect. The SCA held that the enterprise activities conducted by the appellant were the activities of mining, marketing and selling diamonds and that the activities associated with its efforts to meet the statutory duty that it had towards its shareholders²⁸ were too far removed from those enterprise activities to be regarded as being in the course or furtherance of its enterprise.

²⁵ The element of profit-making is addressed at the end of paragraph (a) of the definition. For the purpose of having a definition which is sufficiently wide to capture all kinds of business activities, the definition specifically includes activities which are carried out on a not-for-profit basis. Reference is also made specifically to the activities of an association or a club which are usually conducted in a businesslike manner. (This is a reference to an association not for gain – a term which is also defined in the VAT Act.)

²⁶ Where the term "business" is referred to in the rest of this Note, it is used to augment the explanation of the activities discussed in the context of an "enterprise", and in particular, it is used to refer to the activities of ordinary businesses contemplated in paragraph (a) of that definition. The term is therefore to be interpreted in a wider sense than the ordinary meaning. However, the interpretation should not be applied so widely that it detracts from the context of the definition which requires that the activities are conducted with the purpose of making supplies of goods or services for a consideration.

²⁷ ITC 853 (2011)73 SATC.

²⁸ As a result of this finding, the costs associated with performing the non-taxable activities could not qualify as input tax. Further, as certain services were acquired from a non-resident for this non-taxable purpose, the appellant was liable to pay VAT on imported services under section 7(1)(c).

“continuously or regularly”

The definition also contemplates that the business or enterprise activity is carried on all the time (continuously), or it must be carried on at reasonably short intervals (regularly). “Continuously” is generally interpreted as ongoing, that is, the duration of the activity has neither ceased in a permanent sense, nor has it been interrupted in a substantial way. The term “regular” refers to an activity that takes place repeatedly. Therefore, an activity can be “regular” if it is repeated at reasonably fixed intervals taking into consideration the type of supply and the time taken to complete the activities associated with making the supply.

“by any person”

An enterprise can be conducted by any type of person. The term “person” can include a sole proprietor (natural person), public authority, municipality, company, corporate or unincorporated bodies of persons, deceased or insolvent estate, trust fund, or a foreign donor-funded project. The nature of the person that conducts the enterprise is not usually important, as the definition is primarily activity based. However, in parts of the definition, certain persons are mentioned for specific reasons. For example, reference is made in paragraph (a) to an “association or club” to make it clear that the activities of these entities may qualify as enterprise activities, even if they are conducted on a not-for-profit basis. The activities of municipalities are also specifically included in paragraph (a). Public authorities and welfare organisations²⁹ are referred to in paragraphs (b)(i) and (b)(ii) of the definition, as there are special rules which apply.³⁰

“in the Republic or partly in the Republic”

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. For the purposes of this Note, it is assumed that the enterprise activities are conducted in South Africa.

“in the course or furtherance of which goods or services are supplied”

As VAT is a tax levied on the supply of goods or services by a vendor, it stands to reason that this phrase is the focus of attention in the definition of “enterprise”. It is the fundamental concept which underpins the VAT system as a whole, as there can be no “enterprise” if no goods or services are supplied. However, any supply of goods or services which is exempt under section 12 is excluded from qualifying as an enterprise activity under proviso (v) to the definition. In addition to the exclusion of exempt supplies from the concept of an “enterprise”, the supply of certain other goods or services may fall entirely outside of the definition of “enterprise”. For example, certain supplies which are not made for a consideration, or the supply of private assets of a vendor which are not associated in any way with the enterprise activities carried on, are not supplies made in the course or furtherance of an enterprise, even if that person is a registered vendor.

The terms “supply”, “goods” and “services” are all defined very widely.³¹ This is to ensure that the tax base is as wide as possible so that almost all transactions in the economy (except those purposefully excluded) will be potentially taxable. “Goods” essentially refers to tangible property and rights in tangible property, whereas

²⁹ Both of the terms “public authority” and “welfare organisation” are defined in section 1(1).

³⁰ These will be discussed later in the Note. Refer to **5.2.8 to 5.2.11**.

³¹ The terms “supply”, “goods” and “services” are all defined in section 1(1). For the purposes of this Note, it is not necessary to discuss the meaning of these terms in any further detail.

“services” refers to intangible property and anything which a person does, or anything which is not captured by the definition of the term “goods”. Therefore, in a commercial transaction where something is supplied from one person to another, it will generally constitute the supply of goods or services and will potentially be taxable.³² The supply of “money” when used as a medium of exchange to facilitate the payment of consideration for a transaction is not, in itself, regarded as a supply of goods or services. A cash donation can therefore not be a supply of goods or services for no consideration.

“to any other person for a consideration, whether or not for profit”

When considering the phrase “...for a consideration...” as part of the test for an enterprise, the question arises as to how these words are to be interpreted. For example, must they be interpreted narrowly so that each and every supply not made for a consideration is a non-taxable supply? Or is a more general test applied where the activities and supplies made by the person as a whole are considered to establish if some, or all, of those activities qualify as “enterprise” activities?

It is considered that the latter approach is the correct one, but in applying this test, it cannot be concluded that once a person is found to be carrying on an enterprise, that all the activities and supplies automatically become taxable, or that all acquisitions are for enterprise purposes.³³ What is required is that the various types of activities conducted are to be tested against the definition. If a particular activity meets all the requirements of an enterprise, including that it generally involves making supplies of goods or services for a consideration (whether or not it is a profitable activity), that person will be conducting an enterprise. However, if the person also conducts other non-taxable activities which do not involve the making of supplies for a consideration, to that extent, the person does not carry on an enterprise.

A vendor that distributes free samples of its taxable products for testing or sampling by the general public to promote its taxable supplies, is clearly supplying those samples in the course or furtherance of the enterprise. However, if that same vendor manufactures and distributes free literature to promote a particular faith or belief system, those specific activities do not constitute taxable supplies as there are no enterprise activities (i.e. taxable supplies made for a consideration) to which the literature can be attributed. In such a case, the vendor will be conducting taxable and non-taxable activities and will not be able to recover input tax to the extent that the expenditure is associated with the non-taxable supplies. Input tax may also not be recovered if the vendor carries on activities of a private or recreational nature such as a hobby, or if the activities do not give rise to, or are not in connection with, a supply of goods or services to any other person.

The words “whether or not for profit” indicates that the test for an “enterprise” in terms of paragraph (a) is not, as a general rule, concerned with whether the consideration charged by the person for the goods or services supplied is sufficient to cover the costs of conducting the activity.³⁴ In other words, if an activity does not turn out to be profitable, it does not mean that no “enterprise” is conducted. A further implication is

³² Even a donation (other than cash) or the supply of a promotional product for no consideration may constitute a supply of goods or services. Similarly, any transaction whereby ownership of goods passes from one person to another is regarded as a “sale” as defined in section 1(1).

³³ This view was confirmed in the *De Beers* case. Refer to paragraphs 35 and 36 of the judgment by the SCA.

³⁴ There is an exception in the case of “entertainment” supplied in certain circumstances. Refer to section 17(2)(a).

that the general test for an “enterprise” will apply to associations not for gain, even though they are generally not focussed on making a “profit” except for the purposes of sustaining the organisation’s existence. It should be noted, however, that an association not for gain does not qualify as an enterprise to the extent that it makes supplies for no consideration, except to the extent that it qualifies as a “welfare organisation” carrying on “welfare activities”, or the supplies are integral to its taxable supplies which are made for a consideration in a business context as described in **5.2** of this Note.

Paragraph (b)

Paragraph (b) of the definition deals with some special cases and clarifies the circumstances under which certain entities are regarded as enterprises. This provision commences with the words “...without limiting the applicability of paragraph (a) in respect of any activity carried in the form of a commercial...or professional concern—”. This means that the general rules and the test for business type activities as per the wording of paragraph (a) will still be applicable in the case of the specific entities mentioned in paragraph (b) for it to constitute an enterprise. However, specific additional factors must to be taken into account in this regard.

Paragraph (b)(i)

Public authorities such as government departments and public entities listed in parts A and C of Schedule 3 to the PFMA are dealt with in paragraph (b)(i). As a general rule, public authorities are not regarded as enterprises as they are mainly engaged in carrying out the functions of Government. In certain cases, these entities may be engaged in carrying on business activities which compete with other vendors in the economy. Where this occurs, the Minister of Finance (the Minister) may decide that the entity should be notified to register and account for VAT to the extent that it carries on those business activities.

If the level of business activity is relatively insignificant so that it does not warrant a notification by the Minister, the activities are not regarded as being an enterprise and any supplies made (including those made for no consideration) are out-of-scope for VAT purposes.³⁵

Paragraph (b)(ii)

Paragraph (b)(ii) deals with welfare organisations and provides that these entities are regarded as enterprises to the extent that they carry on any of the welfare activities listed in Government Notice No. 112 dated 11 February 2005. This is despite the fact that some, or all, of the supplies made in connection with its welfare activities might be made for no consideration. The intention of this paragraph is, therefore, to provide welfare organisations with specific tax relief within the VAT system by overriding the general requirement in paragraph (a) that goods or services must be supplied “... for a consideration...”.³⁶ However, if a welfare organisation chooses to register in terms of this provision, it does not mean that it will be able to regard non-taxable supplies as taxable supplies. For example, if a welfare organisation makes exempt supplies as contemplated in section 12, those supplies remain exempt.³⁷ Similarly, whether a welfare organisation registers for VAT or not, it does not change the principle that a

³⁵ Refer to **5.2.8** for more details in this regard as well as Interpretation Note No 39 (issue 2) “VAT Treatment of Public Authorities, Grants and Transfer Payments” (8 February 2013).

³⁶ Refer to **5.2.9 to 5.2.11** as well as **Annexure C** for more details in this regard.

³⁷ Refer also to the discussion in **5.2.9** on the exemption in terms of section 12(b) for associations not for gain.

supply made for no consideration (not being in the course of carrying on a welfare activity) generally falls outside the scope of VAT.³⁸

In other words, exercising the option to register as contemplated in paragraph (b)(ii) does not re-characterise non-taxable supplies and other non-enterprise activities to be carried on in the course or furtherance of an “enterprise”. The provision is limited in its effect in that it only allows supplies made for no consideration by a welfare organisation in the context of conducting welfare activities to be regarded as enterprise activities. Furthermore, to the extent that normal business activities are carried on involving the supply of goods or services for a consideration as contemplated in paragraph (a) of the definition of “enterprise”, the normal rules with regard to the liability to register and account for VAT will apply.

5.1.2 Definition of the term “consideration” [section 1(1)]

The concept of “consideration” is one of the cornerstones of VAT and is defined in relation to the supply of goods or services. It contemplates the making of payments, the performance of certain acts, and the carrying out of forbearances in relation to a supply. Although the definition is very wide and includes any payment which is in respect of, in response to, or for the inducement of the supply of any goods or services, there must be a sufficient nexus between the supply and the payment for the supply to constitute consideration.

In an ordinary business transaction, the consideration is usually determined with reference to an amount of money. However, consideration includes payment in any form and could be in money or in-kind. It could also be in respect of taxable or non-taxable supplies. For example, a reciprocal supply of goods or services in a barter transaction will constitute consideration for each of the parties.

The consideration for a supply could therefore constitute a combination of monetary amounts, reciprocal supplies or acts of forbearance.³⁹ In such cases a value must be attributed to each component of the consideration and aggregated to determine the final VAT-inclusive amount.

Other features of “consideration” are as follows:

- When the term is used with reference to a taxable supply, it is a VAT-inclusive concept. This means that any payment received by the supplier in respect of a supply of goods or services will include an element of VAT, whether payment has been made in part, or in full.
- It includes pre-payments for supplies as well as any past payments in the form of instalments, current payments, or payments which are still to be made in the future in respect of any supply.
- Payment of the consideration does not necessarily have to be made by the recipient of the supply. Consideration can also include payments received from a third party on behalf of the recipient.

³⁸ This means that a welfare organisation must distinguish between supplies made for no consideration which are made in the course of conducting its welfare activities (being taxable supplies) and supplies made for no consideration which are exempt or out-of-scope.

³⁹ The value attributable to the act of agreeing to do something, or not to do something, or to refrain from doing something can also constitute consideration for a supply.

The term “consideration” does not include the following:

- Donations received by associations not for gain (including PBOs and welfare organisations). This includes cash payments as well as the open market value of any donated goods or services where the donor does not expect or receive anything of value in return.⁴⁰
- A deposit⁴¹ (other than a deposit on a returnable container), whether refundable or not, which is given in respect of a supply of goods or services. However, if the supplier applies the deposit as consideration for a taxable supply, or the deposit is forfeited at a later date, only on the happening of that event will the amount constitute consideration.

The definition of the term “consideration” merely determines whether certain payments, acts or forbearances are regarded as consideration. It does not determine the taxable nature or otherwise of a supply for which the consideration is received, nor the amount to be regarded as the consideration. These facts are determined with reference to other provisions. For example, by referring to the definition of “enterprise” in section 1(1) and sections 7, 8, 11 and 12, it can be established if the supply is a taxable supply, and consequently, whether the consideration to which it relates should include VAT or not. Section 10 establishes the value attributable to the supply which will be subject to VAT.

These factors must, therefore, be considered when it is claimed that a supply for no consideration has been made, as the factual position must be established before the VAT consequences of a supply can be determined. It does not mean that because there was no monetary payment that the supply was made for no consideration.

In this context, the first step is to determine if there is indeed no consideration received by the supplier. In other words, in the absence of any monetary amounts paid, the understanding of the parties to the contract must be tested against the definition. This is to confirm that the performance of certain acts or forbearances which are an integral part of the contract, have not been overlooked as a form of consideration. This aspect is of particular importance in complex contracts which involve a number of separate and distinct supplies that may be embedded in the contract.

The second step is to establish whether a nil value (or nil consideration) for each supply is acceptable for VAT purposes. This is done by referring to section 10 and its various subsections which determines the value of supply⁴² which is applicable for

⁴⁰ Refer to **5.1.4** where the term “donation” is discussed in more detail.

⁴¹ The kind of “deposit” referred to in the VAT Act is the type generally referred to as a “security deposit” which is lodged with the supplier to be held as security for the return of borrowed goods, or to secure a supply of goods or services in the future, where the payment will be held in trust until the happening of a future event. The implication is that the security deposit is not taxable at the time that it is lodged, as it does not constitute consideration for a taxable supply at that time. The definition of the term “consideration” also acknowledges that at a later date, that same amount (or a portion thereof) may be applied as consideration for a taxable supply, or be forfeited. A “deposit” must also be distinguished from a pre-payment for a taxable supply which is taxable at the time that the payment is made, and does not qualify as a security deposit.

⁴² The term “value of supply”, is not defined, but it refers to the amount upon which VAT must be levied. Stated differently, it is the price of goods or services charged by a vendor, before adding the VAT component. For a taxable supply which attracts VAT at the standard rate, the value of supply is determined by extracting the VAT component from the final VAT-inclusive price. Although section 10 is called “value of supply”, in some cases a subsection of that provision actually determines the consideration for a supply and not the “value of supply”.

different types of supplies. The answer to this question will depend on the characterisation of the supply, as well as whether the supplier and the recipient are “connected persons”.

5.1.3 Definitions of “input tax” and “taxable supply” [section 1(1)]

The South African VAT system follows the general international principles of input tax as set out in **3**, and in terms of which, “input tax” is defined on the basis of a **purpose test**. A “taxable supply” is a supply which is subject to tax in terms of the VAT Act. This includes standard-rated supplies in terms of section 7(1)(a) and zero-rated supplies in terms of section 11, as well as other supplies which are deemed to be taxable, such as those mentioned in sections 8 and 18 (amongst others).

Input tax may only be deducted to the extent that the expenses incurred can be attributed to the actual use, consumption or supply in the course of making taxable supplies. Where the expenses can be regarded as incurred exclusively for taxable purposes, the input tax may be deducted in full.⁴³ Similarly if the expenses are incurred exclusively for use, consumption or supply in the course of making exempt supplies or for other non-taxable purposes, no input tax may be deducted. If the expense is for both taxable and non-taxable purposes, an apportionment of input tax must be made.

The application of these rules is exactly the same whether it concerns supplies made for a consideration or not. It follows, that in determining the taxable or non-taxable nature of such supplies, the characterisation of the supplies should be carefully considered in accordance with the principles discussed in **3** and **5.1.1**. This characterisation will, in turn, enable a vendor to decide whether the VAT incurred to make those supplies may be deducted as input tax in full, in part, or not at all.

5.1.4 Definition of “donation” [section 1(1)]

The word “donation” is defined to mean any payment in money or otherwise voluntarily made to an association not for gain and in respect of which no identifiable direct valuable benefit arises in the form of a supply of goods or services to the person making the payment, or a connected person in relation to the donor. The definition refers to a situation where a person makes a voluntary (cash) payment or a purely gratuitous disposal of goods or services to an association not for gain.⁴⁴ For a payment or a supply of donated goods or services to qualify as a “donation”, the donor must not receive anything more than mere acknowledgement by the recipient or a small token of gratitude.⁴⁵ The definition intends to make it clear that such a payment or gratuitous disposal does not constitute consideration for a taxable supply by the association not for gain and is excluded from the definition of the term “consideration”. The effect is that the recipient does not account for output tax on any

⁴³ In certain cases, input tax may also be deducted in respect of second-hand goods which are acquired under a non-taxable supply if they are acquired for taxable purposes. Certain other deductions are also allowed to a vendor under section 16(3), but these do not constitute “input tax” as defined. Input tax is also denied in certain cases. For example, as a general rule any VAT incurred in respect of entertainment and motor cars may not be deducted.

⁴⁴ An association not for gain includes a wide range of non-profit organisations, including a “welfare organisation”.

⁴⁵ The token of gratitude or acknowledgement or benefit should not be of significant value, otherwise it could constitute consideration for a taxable supply made by the recipient. Whether a benefit is an “identifiable direct valuable benefit” to the donor or a connected person in relation to the donor is a matter of fact, degree and circumstance.

donation received, and the donor may not deduct any input tax on any donation made.

The definition does not, however, deal with situations where goods or services are “donated” to persons other than associations not for gain. In such cases, one would have to consider the ordinary meaning of the term “donation” and its application in tax law. In this regard, it is worth noting that in our law, there is a presumption against the making of a donation unless the facts and circumstances clearly indicate the contrary.⁴⁶ The common law definition refers to a transaction whereby one person, without any legal obligation to do so, undertakes out of disinterested benevolence to give property to another person without receiving anything in return.⁴⁷

When applying these principles, it is submitted that:

- If a vendor makes a truly gratuitous supply of goods or services, that supply will generally not be regarded as being in the course or furtherance of an enterprise, except where that vendor is a welfare organisation.⁴⁸ Consequently, as a general rule, input tax cannot be deducted on any goods or services which are acquired for the purpose of making supplies for no consideration. There are, however, a few exceptions as explained in the examples in **5.2**.
- When a so-called “donation” is made in circumstances other than that contemplated under the defined term, the VAT consequences will depend on whether the payment or goods or services supplied to the recipient has been made completely gratuitously under the condition of “disinterested benevolence”, or whether it constitutes “consideration” for a taxable supply in whole, or in part.
- If stock items or other enterprise assets on which the vendor has previously deducted input tax are donated, an output tax adjustment must be made.⁴⁹
- When an enterprise makes a supply for no consideration which is integral to the promotion of its taxable supplies (for example, free samples, corporate gifts or special offers) these are not regarded as true donations. The reason is that the goods are not supplied gratuitously under the condition of “disinterested benevolence”. Rather, they are supplied under conditions which are inextricably linked to motives connected to the furtherance of the vendor’s taxable activities.

⁴⁶ Refer for example, to *Myers v Lesch* 1954 (2) SA 487 (T) and *Jepson NO v Lezar* (6453/2007) [2009] ZAFSHC 49.

⁴⁷ Refer also to paragraph 6.2.2 of the specific proposals relating to the fiscal issues affecting non-profit organisations in the Ninth Interim Report of the Commission of Inquiry into certain Aspects of the Tax Structure of South Africa (Katz Commission). In the Report, it was recommended that in the context of donations tax, the statutory definition in the Income Tax Act should be amended to accord with that of the common law.

⁴⁸ There are special rules which apply in respect of welfare organisations which, as a benefit, are afforded the opportunity to voluntarily register for VAT and to claim a deduction of input tax incurred in carrying out their welfare activities, even if supplies are made for no consideration. Refer to **5.2.11** for more details.

⁴⁹ Refer to section 18(1) and **5.1.6**. The adjustment is based on the open market value of the donated goods or services.

5.1.5 Value of supply [section 10(23)]

This provision is made subject to any other value of supply rule which may apply in the circumstances. This means that if there is a possibility of two different valuation rules being applicable in respect of a particular supply, the nil value in terms of section 10(23) will not apply.

The following are examples of when section 10(23) can apply:

- Taxable supplies made between connected persons where the recipient will apply the goods or services wholly for taxable supplies and will be able to deduct the full amount of input tax, regardless of the consideration charged. (In other words, when the open market value in terms of section 10(4) does not apply.)
- Promotional supplies made for no consideration to customers and potential customers who are not connected persons in relation to the supplier.

The purpose of this provision is merely to provide a valuation rule which determines that the value of a supply will be nil in certain instances. The rule cannot be used to characterise a supply. In other words, the valuation rule does not have the effect of changing the character of a non-taxable supply for no consideration into a taxable supply for no consideration just because the person happens to be a vendor in respect of other (taxable) supplies made.⁵⁰

Whilst a nil value may be acceptable in certain cases under this provision for VAT purposes, this does not mean that a nil value will be accepted for other taxes, for example, in the case of an export to a non-resident connected person.⁵¹

5.1.6 Adjustments [section 18(1)]

This provision operates on the basis that if a vendor acquired goods or services for taxable purposes, and later, applies those goods or services wholly for exempt, private, or other non-taxable purposes, an output tax adjustment must be made. Essentially, the purpose of this adjustment is to act as a recoupment of input tax previously deducted. The VAT adjustment is calculated by applying the tax fraction (14/114) to the open market value of the goods or services concerned.

The provision will, for instance, apply when goods initially acquired for taxable purposes are subsequently donated,⁵² as this is regarded as a complete change in use to non-taxable purposes. However, in the case of expenses incurred to acquire promotional products such as free samples which are given to customers or potential customers as an integral part of an effort to market the vendor's taxable products, no adjustment will arise.⁵³

⁵⁰ Refer to case VAT 711.

⁵¹ The reason for this is that there may be different factors which come into play when it concerns the income tax implications of transfer pricing matters or customs valuation issues.

⁵² Refer to 5.1.4 – Definition of “donation”.

⁵³ Refer to 5.2.2 for the reasoning behind this conclusion.

5.2 Supplies made for no consideration

5.2.1 Introduction

If an enterprise is to be successful, or at least sustainable, it will engage in a wide range of activities to further its cause. This may involve various forms of advertising, publicity, distribution of product samples, sales promotions, competitions, special offers, giveaways, discounts, bonuses, product “add-ons” etc. These activities are generally referred to as “marketing activities”. In carrying out its marketing activities, a vendor will sometimes make a supply of goods or services to its customers, employees or any other potential consumer without charging a consideration. In the case of associations not for gain, this may include token gifts as a way of promoting a fundraising event to solicit donations, or the production and free distribution of information booklets which promote the organisation and its cause. As discussed in **3** and **5.1**, it must be established whether the supplies made in the circumstances constitute taxable supplies or non-taxable supplies. This is determined by the characterisation of those supplies as contemplated in the definition of “enterprise”.

In **5.2.2** to **5.2.11**, the VAT implications of supplies made for no consideration under different circumstances are discussed. As it is impractical in this Note to cover all possible situations in which supplies for no consideration can be made, the general principles which are to be applied are set out in **5.2.2** as a “general rule”. This is followed in **5.2.3** to **5.2.11** by a discussion of a number of different situations which demonstrate the practical application of these principles.

5.2.2 General rule

The question as to whether a vendor must account for output tax and deduct input tax on supplies made for no consideration depends on whether the supplies are regarded as being made in the course or furtherance of the vendor’s “enterprise” or not. It follows that output tax must be declared on taxable supplies made, and the VAT incurred on activities which are conducted for the purpose of making those taxable supplies may be deducted as input tax.⁵⁴ When exempt or other non-taxable supplies are made for no consideration, no output tax is declared and no input tax is deducted by the vendor.

The general rule is, therefore, that a supply made for no consideration by a vendor in the context of a business activity or enterprise carried on, is generally regarded as a taxable supply made in the course or furtherance of the “enterprise” as defined in section 1(1). It is a requirement in this regard that the marketing activity and associated marketing expenses are directly attributable to the promotion of the vendor’s taxable product offerings which are usually supplied for a consideration. The effect is that the VAT incurred on the marketing efforts, including certain promotional supplies made for no consideration, may be deducted if the expenses can be directly attributed to specific taxable supplies made for a consideration, or generally, for the purpose of promoting the vendor’s other taxable product offerings. The view is also that a promotional supply made for no consideration such as a free

⁵⁴ As a matter of principle, output tax must be declared on a taxable supply made for no consideration, but where the value is nil in terms of section 10(23), the output tax is calculated as being nil. If section 10(23) does not apply, output tax must be declared on the consideration or value of supply as determined elsewhere in section 10, or any other provision which applies. For example, in the case of **certain** transactions between connected persons, output tax must be declared on the open market value of the supply. In the case of enterprise assets which are subject to a change in use for non-taxable purposes (for example, when applied for own use or when donated), an output tax adjustment based on the open market value must be made.

sample or special offer giveaway which is intended to promote a vendor's taxable product offerings is not regarded as a "donation" in the true sense of the word, as it is not purely gratuitous.

When considering the application of the general rule in this paragraph as it applies in the rest of this Note, it should be kept in mind that the VAT Act contains certain provisions which will specifically deny input tax in certain circumstances.⁵⁵ Where this is the case, it will override the general rule that input tax may be deducted. The general rule will also not apply when the supplies concerned are characterised as exempt or out-of-scope for VAT purposes, because to that extent, the supplies are not made in the course or furtherance of the "enterprise".⁵⁶

5.2.3 Promotional products and other "free" supplies

As mentioned in 5.2.2, input tax can usually be deducted on promotional expenses incurred to make a supply for no consideration if that supply promotes the taxable product offerings of the vendor. A supply such as a free sample will therefore generally constitute a taxable supply and no output tax adjustment is required as set out in 5.1.6. The reason is that the promotional products are disposed of with a commercial rationale in mind rather than under the condition of disinterested benevolence.

Examples of promotional offerings which give rise to supplies for no consideration include the following:

- (a) "Two for the price of one", "buy two and get the third one free", or "buy product X and get product Y for free".
- (b) Free products or corporate gifts awarded to loyal customers, or when purchases exceed a certain threshold.
- (c) Free trials or samples of new products provided to customers or potential customers.
- (d) Legal or accounting services provided to customers and indigent persons on the basis of a contingent outcome or on a *pro bono* basis.

A few points to note about the supplies in (a) to (d) above:

- (a) In a "two for the price of one" type promotion, output tax is effectively only accounted for on the actual (discounted) consideration received and input tax may be deducted in full if the supplies are taxable. However, if the promotion involves the supply of two or more different products which are subject to different VAT treatment, the consideration must be split between the standard-rated, zero-rated and non-taxable components.⁵⁷ Input tax in relation to the non-taxable components may not be deducted, or the input tax will have to be apportioned, depending on the circumstances. A split in the consideration is not required where the "free" product is subject to VAT at the zero rate, for example, "buy a toaster and get a dozen eggs for free." The same rules apply to "add-ons" or "extras" which are advertised as being complimentary or ancillary to another product purchased at the standard rate.

⁵⁵ Refer to section 17(2). For example, if the enterprise is not in the business of supplying "entertainment" as defined, any free entertainment supplied to customers or potential customers will be denied under section 17(2)(a).

⁵⁶ Refer, for example, to proviso (v) to the definition of "enterprise" in section 1(1) which specifically excludes exempt supplies.

⁵⁷ Refer to sections 8(15) and 10(22).

For example, motor dealers often include certain extras for free if a vehicle is purchased under certain conditions, or by a certain date.

- (b) Free gifts such as bottles of wine or other entertainment are not regarded as taxable supplies⁵⁸ unless the vendor is in the business of supplying that type of entertainment for a consideration as contemplated in the first proviso to section 17(2)(a). The VAT treatment of “free” products supplied in response to purchases above a certain threshold will depend on whether the supply is made merely because a condition of sale was met, or if the supply is made for a consideration as part of a barter transaction, or if it is a discount/rebate.⁵⁹
- (c) For free samples, the general rules as discussed in **5.2.2** will apply. However, as mentioned in **(b)** above, this will depend on the nature of the supply and whether the free sample is representative of, or closely associated with, the taxable products which the vendor usually supplies for a consideration.
- (d) The general rules as discussed in **5.2.2** will apply to legal or accounting services which are undertaken on the basis of a contingent outcome or on a *pro bono* basis. Once again, these supplies are regarded as integral to the making of other taxable supplies of the same type for which a consideration is usually charged to clients by the vendor. If a small fee is charged, or some of the costs are recouped once the work is complete, or the full fee is payable later upon a successful outcome, those amounts will constitute consideration for a taxable supply which is subject to VAT at the applicable rate (usually the standard rate).

5.2.4 Supplies between “connected persons”

When a taxable supply is made between connected persons for no consideration, a nil value in terms of section 10(23) may be acceptable if the conditions in section 10(4) do not apply. For example, if a vendor makes a taxable supply for no consideration to one of its separate VAT-registered branches, a nil value will apply if the recipient would have been able to deduct the full input tax credit had a consideration equal to the open market value for the supply been charged. In other words, if the recipient is a vendor and the taxable supplies are acquired wholly for taxable use in its enterprise, a nil value may be used. However, if the recipient is not a vendor, or the taxable supplies are acquired wholly or partly for exempt or other non-taxable purposes, VAT must be declared by the supplier on the open market value in terms of section 10(4).⁶⁰

⁵⁸ Refer to the *VAT 411 - Guide for Entertainment Accommodation and Catering* for more information in this regard. The supply of “entertainment” in such cases is regarded as being out-of-scope for VAT purposes.

⁵⁹ Refer to binding general rulings BGR 5 and BGR 6 for further information on discounts, rebates and incentives.

⁶⁰ If the open market value of the supply made for no consideration is not applicable under section 10(4), this does not necessarily mean that the supply will escape the provisions of section 73 of the Act (Schemes for obtaining undue tax benefits), or any similar provision in another tax act.

5.2.5 Corporate social responsibility (CSR) expenses

Expenditure by a vendor in accordance with its CSR objectives is not always deductible for VAT purposes, whether it is to comply with a statutory requirement, or as part of a voluntary programme. Also, such expenditure does not always give rise to a supply of goods or services to another person for no consideration. This will depend on the facts and circumstances of the case. For example, a cash donation to a PBO may be deductible for income tax purposes if certain requirements are met, but it does not constitute a supply of goods or services and will not result in any input tax credit for the donor.

The leading case for income tax in this regard is *Warner Lambert SA (Pty) Ltd v SARS*.⁶¹ In this case it was held by the Supreme Court of Appeal that the so-called “Sullivan Code” expenditure in question was deductible under section 11(a) of the Income Tax Act as it was incurred in the production of income, and found not to be of a capital nature. The expenditure was found to be incurred, not out of pure liberality (or “disinterested benevolence”), but was inextricably linked to motives connected to the furtherance of the taxpayer’s trading activities. Generally, the principles in the *Warner Lambert* case can also be applied under the VAT Act, in the sense that an expense which is incurred “in the production of income” for income tax purposes, will usually also be incurred “in the course or furtherance of an enterprise” for VAT purposes.⁶² However, one should be careful to identify each expense and the purpose for which the expense was incurred. If the expense, being of a revenue nature, is not in connection with any exempt or other non-taxable purpose, the expense might qualify for a deduction under both income tax and VAT legislation. However, that same expense, if it were of a capital nature, might be deductible for VAT purposes, but not for income tax purposes.

In cases where expenditure is incurred for more than one purpose, the income tax provisions relating to the deductibility of expenditure provide that the amount may be disallowed “to the extent that it is not incurred for the purposes of trade”.⁶³ The VAT Act also contains similar provisions⁶⁴ and in such cases, the input tax may have to be apportioned if it cannot be directly attributed wholly for taxable, exempt, or other non-taxable purposes.

From the above, it is clear that there is no single test that can be applied, except for the general rules which have been identified in 5.2.2. Vendors should therefore be careful not to draw their conclusions on the deductibility of an expense under the VAT law with reference to income tax legislation and associated case law, as the result will not necessarily be the same. Factors such as the nature, type and purpose of the expense, the taxable nature or otherwise of the supplies to which the expense relates, and the facts and circumstances of the case must be carefully considered.

One principle that emerges is that if the expenditure is incurred for purely gratuitous purposes and cannot be attributed to the taxable enterprise activities of the vendor,

⁶¹ (2003) (65 SATC 347).

⁶² This is on the understanding that the particular expense being considered is attributable to both the making of taxable supplies under the VAT Act and the earning of taxable income under the Income Tax Act. If the expense is attributable to exempt supplies under the VAT Act, or the earning of exempt income under the Income Tax Act, no deduction will be allowed under the respective Acts.

⁶³ See for example, *CIR v Pick 'n Pay Wholesalers (Pty) Ltd* 1987 (3) SA 453 (A), 49 SATC 132, and section 23(g) of the Income Tax Act.

⁶⁴ Refer to section 17(1) and the definition of the term “input tax” in section 1(1).

for example, in the form of brand marketing, publicity, increased sales or advertising, it is unlikely that it will be deductible for VAT purposes.

5.2.6 Fringe benefits

A fringe benefit arises when an employer makes a supply of enterprise assets (or the use thereof) to an employee for no charge, or for a charge which is less than the cash equivalent. As a general rule, a fringe benefit is regarded as a supply of goods or services made in the course or furtherance of a vendor's enterprise (unless it is a loan of money or other exempt supply). Vendors that are employers must therefore account for output tax on the value of any benefit or advantage granted, as determined with reference to the Seventh Schedule to the Income Tax Act. Where the benefit consists of a right to use a motor vehicle, the consideration is determined in terms of *Regulation No. 2835* dated 22 November 1991.

Input tax may be deducted on any goods or services acquired for the purpose of making a supply of a fringe benefit to an employee for no consideration, however, where the benefit or advantage constitutes the supply of "entertainment" or the use of a motor car, the input tax is generally denied.

If the benefit or advantage is an exempt supply⁶⁵ in terms of section 12 or a zero-rated supply in terms of section 11, no fringe benefit arises and the employer is not required to declare any output tax. Any VAT incurred by the employer to make a supply of a fringe benefit which is taxable at the zero rate may be deducted as input tax. Similarly, when the value of the benefit provided to the employee is nil in terms of the Seventh Schedule to the Income Tax Act, the employer will not declare any output tax.⁶⁶ Usually when the value of the benefit is determined to be nil, this will relate to a general benefit provided to all employees. The employer may therefore deduct input tax in such cases to the extent that the associated expenses relate to the making of taxable supplies. If the employer supplies the fringe benefit to employees who are involved in both taxable and non-taxable activities, the input tax must be apportioned.

In the case of a long service award such as a gold watch awarded to an employee, the same principles apply as discussed in the preceding paragraph. If the award is in the form of a cash payment, no input tax may be deducted.

5.2.7 Municipalities

Municipalities are regarded as normal businesses as contemplated in paragraph (a) of the definition of "enterprise" with effect from 1 July 2006, and will be required to register and account for VAT. The general rules in **5.2.2** and as discussed elsewhere in this Note are therefore equally applicable to municipalities.

Municipalities are involved in supplying a wide variety of goods and services including water, electricity, refuse removal, sanitation services, public gardens, public roads and street lighting. Before 1 July 2006, only certain types of business activities were deemed to be taxable supplies made in the course or furtherance of the municipality's enterprise. The supply of water, electricity, sanitation, refuse removal and similar supplies has always been taxable.

⁶⁵ An example is where the employer supplies a dwelling to the employee. No fringe benefit arises in this case as the supply of a dwelling is exempt in terms of section 12(c).

⁶⁶ An example is a supply of hospitalisation services provided by the employer to its employees who are injured on duty.

From 1 July 2006, amendments to the VAT Act were introduced to make the supplies which were previously out-of-scope to be taxable supplies so that output tax must be declared on any consideration charged.⁶⁷ The amendments also unlocked the VAT incurred on the costs of making those supplies so that input tax could be deducted by the municipality.

Municipalities supply water and electricity for a consideration to customers, but, as required in terms of the Constitution, they also supply a certain amount of “free” water and electricity to domestic households, people in rural areas and indigent persons. This is usually referred to as “free basic services” and is funded from equitable share grants received from government. Since the supply of water and electricity by a municipality constitutes taxable supplies, which are usually supplied for a consideration, the supply of any free basic services is regarded as part of the municipality’s taxable supplies. This means that a municipality is not required to make an adjustment under section 18(1) for any input tax previously deducted on bulk water and electricity purchased from other vendors for the purpose of making those supplies. Any consumption by paying customers above the “free” amount is subject to VAT at the standard rate. Output tax is therefore only paid by the municipality on the actual price charged over and above any “free” portion.

When a municipality outsources the supply of water, electricity, or any other taxable activity to a municipal entity, that municipal entity does not make a supply for no consideration to the municipality. As a municipal entity is a “designated entity”, any payment received from a municipality in respect of such supplies does not qualify as a zero-rated “grant”.⁶⁸ An example of this is when a municipality engages the services of a “water service provider” (WSP) to supply water to customers in a particular water service area. Any payment by the municipality to the WSP constitutes consideration for the taxable supply of services and is taxable in full at the standard rate.

A further example to consider is the supply by municipalities of goods and services to the general public. Although it may seem that certain supplies such as public roads, parks and gardens, public recreation facilities and street lighting are supplies made for no consideration, this is not the case. From 1 July 2006, the policy is that the amount of municipal property rates charged to property owners constitutes the consideration for the provision of the public goods and services. The “municipal rate” charged by a municipality is taxable at the zero rate⁶⁹ to the extent that it represents a charge for making taxable supplies of public amenities. This means that the municipality will be able to recover VAT to the extent that expenses are incurred for the purpose of making taxable supplies of public amenities (excluding any exempt supplies).⁷⁰ If an entrance fee is charged, or other consideration is payable for the use of those public facilities, the amount charged is subject to VAT at the standard rate.

⁶⁷ It should be noted that the purpose of the deletion of paragraph (c) of the definition of “enterprise”, and the introduction of other consequential amendments affecting the VAT treatment of municipalities was to re-characterise the supplies which were out-of-scope before 1 July 2006 to be taxable supplies after that date. One of the objectives was to simplify the administration of VAT within municipalities so that the normal rules applicable under paragraph (a) of the definition of “enterprise” could also apply to municipalities. This re-characterisation does not apply to any supplies which are exempt in terms of section 12. Where a supply was exempt before 1 July 2006, it remains exempt after that date.

⁶⁸ Refer to section 8(5) and the definitions of “grant” and “designated entity” in section 1(1).

⁶⁹ Refer to section 11(2)(w).

⁷⁰ For more information on this topic refer to the *VAT 419 Guide for Municipalities*.

5.2.8 Public authorities, public entities and designated entities

In terms of paragraph (b)(i) of the definition of “enterprise”, public authorities are generally not regarded as enterprises and will not be vendors unless specifically notified by the Minister to register. They will therefore not account for output tax or deduct input tax on any goods or services that they supply, whether a consideration is charged or not. To the extent that a public authority is notified by the Minister to register for VAT, it will be a “designated entity” and will be regarded as a normal business as contemplated in paragraph (a) of the definition of “enterprise”.

Major public entities listed in Schedule 2 of the PFMA, national or provincial government business enterprises listed in Parts B or D of Schedule 3 to the PFMA, and entities which are a party to any Public Private Partnership (PPP) are also designated entities, but they are not required to be notified to register for VAT. The funding that designated entities receive from National or Provincial Government is generally treated on the same basis as the consideration received by other vendors for making the same or similar taxable supplies (that is, subject to VAT at the standard rate).

To the extent that designated entities make supplies for no consideration, the general rules as discussed in 5.2.2 or in the specific circumstances described elsewhere in this Note which are relevant to the situation will apply.⁷¹

5.2.9 Associations not for gain

One of the difficulties in establishing the correct VAT treatment of supplies made by associations not for gain is the different terminology and definitions used in the Income Tax and VAT Acts. For example, the terms “recreational club” and “public benefit organisation” (PBO) are defined for income tax purposes, but not for VAT purposes.

The VAT Act, in turn, defines the terms “association not for gain” and “welfare organisation”. As a result, the VAT treatment of these organisations can be quite difficult to understand.⁷²

An “association not for gain” as defined in the VAT Act means –

- (i) any religious institution of a public character;
- (ii) any other organisation (except an educational institution) which does not carry on its activities for the purposes of profit or gain to any owner, member or shareholder; and
- (iii) educational institutions of a public character.

The definition covers a wide spectrum of different entities and may therefore include societies, such as those formed for the promotion of culture and arts, charities and public-interest groups. At one end of the spectrum are sports and recreational clubs which, although formed to promote the interests of a group of persons, they are mainly focused on satisfying the needs of their membership base. Typically,

⁷¹ For more information on this topic refer to Interpretation Note No. 39 (Issue 2) “VAT Treatment of Public Authorities, Grants and Transfer Payments” (8 February 2013).

⁷² For a detailed discussion on the relationship between associations not for gain, PBOs and welfare organizations, refer to Chapter 3 of the *VAT 414 - Guide for Associations not for Gain and Welfare Organisations*. Refer also to the extracts from the VATCOM report in **Annexure C** for the policy framework and background.

members join an association (club) to fulfil their personal needs and pay for this by way of a membership fee or subscription. At the other end of the spectrum are PBOs and welfare organisations which are more focused on satisfying the needs of the general public, or a sector of the general public. Typically, these organisations are involved in charitable work or activities of a benevolent, philanthropic or altruistic nature.

Unlike ordinary businesses that further their objectives solely through commercial activities, associations not for gain have a complex variety of income sources including: donations, bequests, street collections, tithes, and fundraising activities such as fares and jumble sales. They will often also conduct some form of commercial activity which is similar to an ordinary business to generate additional income to ensure that the activities of the organisation can be sustained in the future. As the income streams are fairly complex and they often make supplies for no consideration, it is highly likely that there will be a mixture of business and non-business activities conducted.⁷³ Consequently, there may be a mixture of standard-rated and zero-rated taxable supplies, exempt supplies, and supplies which are outside the scope of VAT.

Except for the exemption provided in section 12(b), the VAT legislation does not contain a specific exemption for the activities of associations not for gain. This means that if supplies are made for a consideration and the value of the supplies exceeds the compulsory VAT registration threshold of R1 million in any consecutive 12-month period, the entity will be required to register for VAT. The option of voluntary registration is also available if supplies are made in excess of the minimum voluntary registration threshold of R50 000⁷⁴ in any consecutive 12-month period.

To the extent that an association not for gain carries on ordinary business activities as contemplated in paragraph (a) of the definition of “enterprise”, the general rule as set out in **5.2.2** will apply.

A few other points to be noted in regard to associations not for gain:

- If an association not for gain supplies goods or services which it received as a donation, the supply is exempt in terms of section 12(b). The exemption applies whether the supply is made for a consideration or not.⁷⁵
- An association not for gain is not a “PBO” or a “welfare organisation” unless it meets the requirements. If some of the activities are of the type listed in Part I of the Ninth Schedule to the Income Tax Act, and the association has been approved as a PBO under section 30(3) of that Act, it will only be a PBO to that extent. To qualify as a “welfare organisation” it must firstly be an approved PBO and it must also carry on “welfare activities” as listed in Regulation No. 112 in the *Government Gazette* No. 27235 issued on 11 February 2005 (*Regulation 112*). (Refer to **Annexure B**.)
- An association not for gain must be formally established and have a written constitution, otherwise it is regarded as an ordinary business and will not be entitled to any of the benefits which are available to an association not for

⁷³ For a detailed analysis on the aims and objectives of associations not for gain and their ability to earn and retain profits, refer to *Cuninghame v First Ready Development 249* (28 September 2009) (238/08) [2009] ZASCA.

⁷⁴ The threshold is R60 000 in the case of entities supplying “commercial accommodation”.

⁷⁵ Note, however, that the exemption in section 12(b) only applies to an “association not for gain” which is not a “welfare organisation”.

gain under the VAT Act. Informal clubs and societies are not regarded as enterprises if the activities are essentially self-interest based and carried on in the manner of a hobby or private activity. For example, where a few individuals form an informal club and get together each week to play cards and entertain themselves, no enterprise is conducted.

5.2.10 Welfare organisations

A welfare organisation is a special type of association not for gain. Therefore, if a provision of the VAT Act applies to an association not for gain, it will also apply to a welfare organisation.⁷⁶ To the extent that a welfare organisation carries on business activities, the same rules as set out in **5.2.9** for an association not for gain will apply. However, welfare organisations are also entitled to certain other benefits which are not available to an association not for gain. For example, paragraph (b)(ii) of the definition of “enterprise” regards supplies made for no consideration to be taxable supplies to the extent that these are in connection with carrying on certain “welfare activities” listed in *Regulation 112*.

Welfare organisations are therefore provided with an option to register voluntarily without having to meet the minimum threshold, or the requirement that supplies must be made for a consideration. This allows a welfare organisation the ability to claim a refund of input tax in respect of supplies made for no consideration in respect of welfare activities conducted. An additional benefit not available to other vendors is that it is entitled to deduct input tax in respect of soliciting donations as this activity is regarded as an integral part of conducting the “welfare activities”. Note, however, the explanation provided in **5.1.1** on paragraph (b)(ii) of the definition of “enterprise”, that if a welfare organisation decides to register for VAT, this does not mean that exempt supplies, or supplies which are outside the scope of VAT qualify as taxable supplies conducted in the course or furtherance of the welfare organisation’s enterprise.

5.2.11 Public benefit organisations (PBOs)

A “PBO” is defined in the Income Tax Act as any organisation which is a “non-profit company” as defined in section 1 of the Companies Act, 2008,⁷⁷ a trust formed in the Republic, or an association of persons established in the Republic which carries on a public benefit activity (PBA) listed in Part I of the Ninth Schedule to the Income Tax Act and complies with section 30 of the Income Tax Act.

As PBOs fall within the wider definition of an “association not for gain”, the same rules as set out in **5.2.9** will apply to the extent that a PBO carries on business activities. A PBO will not automatically qualify as “welfare organisation” but if it carries on “welfare activities”, **5.2.10** will apply **to that extent**.

As the list of welfare activities for VAT purposes is derived from the PBAs listed in Part I of the Ninth Schedule to the Income Tax Act, in many cases a PBO will also qualify as a welfare organisation. This has resulted in some uncertainty with regard to the application of the law when it comes to certain PBOs that carry on what some might think of as charitable activities which are deserving of welfare status, but which are not listed in *Regulation 112*. Typical examples include: organisations that carry on activities whose aims are primarily of a cultural, religious, political, philanthropic, patriotic, philosophical or philanthropic nature, where supplies are generally made for

⁷⁶ The exemption in section 12(b) does not, however, apply to welfare organisations and is an exception to this rule.

⁷⁷ Act No. 71 of 2008.

no consideration.⁷⁸ Whilst such organisations may possibly qualify as PBOs for income tax purposes, they will not necessarily qualify as welfare organisations under the VAT Act.

Some of these organisations have claimed the benefits applicable to welfare organisations under the VAT Act without meeting the requirements. This was demonstrated in an unreported case heard in August 2009 in the Johannesburg Tax Court⁷⁹ where the principle was confirmed that an association not for gain (including a PBO) is not permitted to deduct input tax on the costs incurred to make supplies for no consideration if those supplies are made in the course of carrying on non-taxable (non-enterprise) activities.

The case concerned a religious organisation which carried on activities in connection with its objective of ministering, promoting, and spreading its religious message. Teachings and messages were spread via various means such as radio and television broadcasts, conventions, the internet, personal correspondence, and by the distribution of certain magazines for no consideration.

The association had also registered for VAT in respect of books, CDs, DVDs and other religious material which it supplied for a consideration through its bookshop. The dispute concerned the disallowance of input tax which was attributable to the religious activities, including the VAT costs associated with the distribution of religious magazines for no consideration.

Whilst the judgment in this case does not go into detail on many of the important principles underpinning the Court's rationale for its decision, the following principles apply:

- Supplies made for no consideration in pursuance of philanthropic causes such as religious, philosophical or other belief systems, do not qualify as taxable supplies carried on in the course or furtherance of an enterprise as contemplated in paragraph (a) of the definition of "enterprise".⁸⁰ Consequently, the supplies are non-taxable and no input tax may be deducted on expenses incurred to make those supplies. Similarly, if an organisation makes exempt or other non-taxable supplies, those supplies are not re-characterised to be taxable supplies carried on in the course or furtherance of an "enterprise" merely because that person registered voluntarily, or is liable to register for VAT in respect of other taxable supplies made.⁸¹
- When VAT is incurred for both taxable and non-taxable purposes, the input tax must be apportioned. Apportionment only applies where the expense cannot be directly (wholly) attributed to either taxable or non-taxable supplies.
- It cannot be concluded that a supply made by a vendor for no consideration is a taxable supply, merely because that person is registered for VAT. The taxable or non-taxable nature of the supply must be based on the

⁷⁸ Also excluded from the list of welfare activities are any supplies which are exempt in terms of section 12 (except those which are of the type contemplated in section 12(b) when they are made by a welfare organisation).

⁷⁹ Case VAT 711.

⁸⁰ This principle applies no matter how benevolent or altruistic the objectives of the organisation may seem.

⁸¹ This rule applies even in the case of a "welfare organisation" which is registered for VAT in respect of "welfare activities" carried on.

characterisation of that supply in accordance with the definition of “enterprise”. The valuation rule in section 10(23) merely provides that the value of a supply is nil in certain circumstances. It cannot be used to characterise a supply as being taxable or non-taxable.

- There is a difference between supplies made for no consideration in promoting religious, philosophical or other belief systems (being supplies which are out-of-scope for VAT purposes), and supplies made for no consideration in carrying on “welfare activities” (which qualify as taxable supplies).
- An approved PBO contemplated in section 30(3) of the Income Tax Act which is exempt from income tax does not necessarily qualify as a “welfare organisation”. It may only claim the benefits of a welfare organisation to the extent that it carries on any of the specified welfare activities set out in *Regulation 112*.

This case highlights one of the main differences in the VAT treatment of an association not for gain (or PBO) and a welfare organisation. The rationale behind the special treatment afforded to welfare organisations is to prevent the VAT on purchases from becoming trapped so that it forms part of the cost of providing welfare goods and services which are generally for the benefit of the poor and needy.

6. Conclusion

This Note explains the factors to consider when determining whether a supply for no consideration is a taxable or non-taxable supply, and consequently, whether there is a liability to declare output tax, or there is a right to deduct input tax on any goods or services acquired to make those supplies.

Supplies made for no consideration can be made under many different circumstances and as it is not possible to cover every situation, the approach of the Note is to provide a general rule in **5.2.2** to illustrate the circumstances under which the VAT incurred in such cases may be deducted as input tax. Further specific scenarios are also discussed in **5.2.3** to **5.2.11** to demonstrate how this rule works in practice within the context of the meaning of an “enterprise” as defined in section 1(1). Further context is provided with reference to some of the generally accepted international principles upon which a VAT system of taxation is based. Of particular importance in this regard is the general requirement that supplies must be made for a consideration.

Most of the difficulties arise when supplies made for no consideration are made by associations not for gain, PBOs and welfare organisations, as they sometimes have a mixture of enterprise and non-enterprise activities. Such organisations may have difficulty in characterising the supplies correctly as taxable or non-taxable, or have difficulty in correctly allocating their expenses in this regard.

When considering the VAT implications of supplies (including supplies made for no consideration), vendors should be careful to characterise the supply correctly in accordance with the definition of “enterprise” as defined in section 1(1). This requires a distinction to be made between taxable supplies made in the course or furtherance of an “enterprise” and any exempt, out-of-scope or other non-taxable supplies.

A distinction must also be made between a situation where supplies are made for no consideration and a situation where no activity or “enterprise” is conducted, because no supplies are made to any other person. In making this distinction it should be kept in mind that section 10(23) is a valuation rule and cannot be used to characterise a supply as being taxable or non-taxable. Section 10(23) merely provides that the valuation of a supply may be nil in certain circumstances.

Input tax and output tax are only accounted for on taxable supplies (standard-rated or the zero-rated supplies). Exempt supplies and any supplies which are outside the scope of VAT constitute non-taxable activities which are not carried on in the course or furtherance of an enterprise.

Activities conducted without giving rise to a supply of goods or services to another person, or which primarily involve the making of supplies for no consideration are generally not regarded as activities conducted in the course or furtherance of an enterprise. Consequently, the VAT incurred in conducting such activities is generally not deductible as input tax. However, where promotional supplies made for no consideration are attributable to the taxable activities conducted by the enterprise, the VAT incurred to make those supplies is generally allowed to the extent that the supplies are made with a commercial rationale in mind. This must be distinguished from a situation where the supplies concerned are purely benevolent in nature. In such a case, the supplies are not regarded as being made in the course or furtherance of an enterprise unless they are made by a “welfare organisation” in the course of conducting its “welfare activities”.

Should any person require further clarity on any of the matters dealt with in this Note, it is recommended that an application for a VAT ruling be made as envisaged in section 41B read with Chapter 7 of the Tax Administration Act 28 of 2011 (the TA Act). The application should be submitted to SARS by email to **VATRulings@sars.gov.za** or facsimile on +27 86 540 9390. The application should be headed “Application for a VAT Class Ruling” or “Application for a VAT Ruling” and it must meet all the requirements as set out in section 79 of the TA Act.

Legal and Policy Division
SOUTH AFRICAN REVENUE SERVICE

Annexure A – The law

Section 1(1) – Definitions

“**association not for gain**” means—

- (a) any religious institution of a public character; or
- (b) any other society, association or organisation, whether incorporated or not (other than an educational institution in respect of which the provisions of paragraph (c) apply), which—
 - (i) is carried on otherwise than for the purposes of profit or gain to any proprietor, member or shareholder; and
 - (ii) is, in terms of its memorandum, articles of association, written rules or other document constituting or governing the activities of that society, association or organisation—
 - (aa) required to utilize any property or income solely in the furtherance of its aims and objects; and
 - (bb) prohibited from transferring any portion thereof directly or indirectly in any manner whatsoever so as to profit any person other than by way of the payment in good faith of reasonable remuneration to any officer or employee of the society, association or organisation for any services actually rendered to such society, association or organisation; and
 - (cc) upon the winding-up or liquidation of such society, association or organisation, obliged to give or transfer its assets remaining after the satisfaction of its liabilities to some other society, association or organisation with objects similar to those of the said society, association or organisation; or
- (c) any educational institution of a public character, whether incorporated or not, which—
 - (i) is carried on otherwise than for the purposes of profit or gain to any proprietor, member or shareholder; and
 - (ii) is, in terms of its memorandum, articles of association, written rules or other document constituting or governing the activities of that educational institution—
 - (aa) required to utilize any property or income solely in the furtherance of its aims and objects; and
 - (bb) prohibited from transferring any portion thereof directly or indirectly in any manner whatsoever so as to profit any person other than by way of the payment in good faith of reasonable remuneration to any officer or employee of the educational institution for any services actually rendered to such institution;

“**consideration**”, in relation to the supply of goods or services to any person, includes any payment made or to be made (including any deposit on any returnable container and tax), whether in money or otherwise, or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods or services, whether by that person or by any other person, but does not include any payment made by any person as a donation to any association not for gain: Provided that a deposit (other than a deposit on a returnable container), whether refundable or not, given in respect of a supply of goods or services shall not be considered as payment made for the supply unless and until the supplier applies the deposit as consideration for the supply or such deposit is forfeited;

“**donation**” means a payment whether in money or otherwise voluntarily made to any association not for gain for the carrying on or the carrying out of the purposes of that association and in respect of which no identifiable direct valuable benefit arises or may arise in the form of a supply of goods or services to the person making that payment or in the form of a supply of goods or services to any other person who is a connected person in relation to the person making the payment, but does not include any payment made by a public authority or a municipality;

“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;
- (b) without limiting the applicability of paragraph (a) in respect of any activity carried on in the form of a commercial, financial, industrial, mining, farming, fishing or professional concern—
 - (i) the making of supplies by any public authority of goods or services which the Minister, having regard to the circumstances of the case, is satisfied are of the same kind or are similar to taxable supplies of goods or services which are or might be made by any person other than such public authority in the course or furtherance of any enterprise, if the Commissioner, in pursuance of a decision of the Minister under this subparagraph, has notified such public authority that its supplies of such goods or services are to be treated as supplies made in the course or furtherance of an enterprise;
 - (ii) the activities of any welfare organisation as respects activities referred to in the definition of “welfare organisation” in this section;
 - (iii) ...
 - (iv) ...
 - (v) the activities of a foreign donor funded project;

...

Provided that—

...

- (iv) any activity carried on by a natural person essentially as a private or recreational pursuit or hobby or any activity carried on by a person other than a natural person which would, if it were carried on by a natural person, be carried on essentially as a private or recreational pursuit or hobby shall not be deemed to be the carrying on of an enterprise;
 - (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;
- ...
- (viii) the making of supplies by a constitutional institution listed in Schedule 1 of the Public Finance Management Act, 1999 (Act No. 1 of 1999), shall be deemed not to be the carrying on of an enterprise;

“input tax”, in relation to a vendor, means—

tax charged under section 7 and payable in terms of that section by—

- (a) a supplier on the supply of goods or services made by that supplier to the vendor; or
- (b) the vendor on the importation of goods by him; or
- (c) the vendor under the provisions of section 7(3);

...

where the 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 or, where the goods or services are acquired by the vendor partly for such purpose, to the extent (as determined in accordance with the provisions of section 17) that the goods or services concerned are acquired by the vendor for such purpose.

“taxable supply” means 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 per cent under section 11;

“welfare organisation” means any public benefit organisation contemplated in paragraph (a) of the definition of “public benefit organisation” in section 30(1) of the Income Tax Act that has been approved by the Commissioner in terms of section 30(3) of that Act, if it carries on or intends to carry on any welfare activity determined by the Minister for purposes of this Act, relating to those activities that fall under the headings—

- (a) welfare and humanitarian;
- (b) health care;
- (c) land and housing;
- (d) education and development; or
- (e) conservation, environment and animal welfare.

Section 10 – Value of supply of goods or services.

(1) For the purposes of this Act the following provisions of this section shall apply for determining the value of any supply of goods or services.

(2) The value to be placed on any supply of goods or services shall, save as is otherwise provided in this section, be the amount of the consideration for such supply, as determined in accordance with the provisions of subsection (3), less so much of such amount as represents tax: Provided that—

- (i) there shall be excluded from such consideration the value of any postage stamp as defined in section 1 of the Post Office Act, 1958 (Act No. 44 of 1958), when used in the payment of consideration for any service supplied by the postal company as defined in section 1 of the Post Office Act, 1958;
- (ii) where the portion of the amount of the said consideration which represents tax is not accounted for separately by the vendor, the said portion shall be deemed to be an amount equal to the tax fraction of that consideration.

(3) For the purposes of this Act the amount of any consideration referred to in this section shall be—

- (a) to the extent that such consideration is a consideration in money, the amount of the money; and
- (b) to the extent that such consideration is not a consideration in money, the open market value of that consideration.

...

(21) Where any supply of entertainment is made by a vendor and in terms of section 17 no deduction of input tax was made in terms of section 16(3) in respect of the acquisition by the vendor of goods or services for the purpose of such entertainment, the value of such supply shall be deemed to be nil.

(22) Where a taxable supply is not the only matter to which a consideration relates, the supply shall be deemed to be for such part of the consideration as is properly attributable to it.

(23) Save as otherwise provided in this section, where any supply is made for no consideration the value of that supply shall be deemed to be nil.

Section 16 – Calculation of VAT

(3) Subject to the provisions of subsection (2) of this section and the provisions of sections 15 and 17, the 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), and the amounts (if any) received by the vendor during that period by way of refunds of tax charged under section 7(1)(b) and (c) and 7(3)(a), the following amounts, namely—

- (a) ...
- (b) ...

Section 18(1) – Adjustments

(1) Subject to the provisions of section 8(2), where—

- (a) goods or services have been supplied to or imported by a vendor; or
- (b) goods have been manufactured, assembled, constructed or produced by him; or
- (c) goods or services were deemed by subsection (4) to have been supplied to him,

(excluding goods or services to the extent that, in respect of the acquisition of which by the vendor a deduction of input tax was denied by section 17(2) or would have been denied if that section had been applicable prior to the commencement date) and such goods or services were acquired, manufactured, assembled, constructed or produced by such vendor wholly or partly for the purpose of consumption, use or supply in the course of making taxable supplies or such goods were held or applied for that purpose, such goods or services shall—

- (i) if they are subsequently applied by him (otherwise than in the circumstances contemplated in section 8(9)) wholly for a purpose other than the said purpose; or
- (ii) if they are subsequently applied by him wholly for a purpose in respect of which, if such goods or services had been acquired by him at the time of such application, a deduction of input tax would have been denied in terms of section 17(2)(a) or (c),

be deemed to have been supplied by him by way of a taxable supply by him in the course of his enterprise.

Annexure B – Listed welfare activities

DETERMINATION OF WELFARE ACTIVITIES FOR PURPOSES OF THE DEFINITION OF “WELFARE ORGANISATION” IN SECTION 1 OF THE VALUE-ADDED TAX ACT, 1991

Published as Regulation No. 112 in the *Government Gazette* No. 27235 on 11 February 2005.

1. WELFARE AND HUMANITARIAN

- (a) The care or counselling of, or the provision of educational programmes relating to abandoned abused neglected, orphaned or homeless children.
- (b) The care or counselling of poor and needy persons where more than 90 per cent of those persons to whom the care or counselling are provided are over the age of 60.
- (c) The care or counselling of, or the provision of educational programmes relating to physically or mentally abused and traumatised persons.
- (d) The provision of disaster relief.
- (e) The rescue or care of persons in distress.
- (f) The provision of poverty relief.
- (g) Rehabilitative care or counselling or education of prisoners, former prisoners and convicted offenders and persons awaiting trial.
- (h) The rehabilitation, care or counselling of persons addicted to a dependence-forming substance or the provision of preventative and educational programmes regarding addiction to dependence-forming substances.
- (i) Conflict resolution, the promotion of reconciliation, mutual respect and tolerance between the various peoples of South Africa.
- (j) The promotion or advocacy of human rights and democracy.
- (k) The protection of the safety of the general public.
- (l) The promotion or protection of family stability.
- (m) The provision of legal services for poor and needy persons.
- (n) The provision of facilities for the protection and care of children under school-going age of poor and needy parents, other than the services contemplated in section 12(j) of the Value-Added Tax Act, 1991.
- (o) The promotion or protection of the rights and interests of, and the care of, asylum seekers and refugees.
- (p) Community development for poor and needy persons and anti-poverty initiative, including-
 - (i) the promotion of community-based projects relating to self-help, empowerment, capacity building, skills development and anti-poverty;
 - (ii) the provision of training, support or assistance to community-based projects contemplated in item (i); or
 - (iii) the provision of training, support or assistance to emerging micro enterprises to improve capacity to start and manage businesses, which may include the granting of loans on such conditions as may be prescribed by the Minister by way of regulation.
- (q) The promotion of access to media and a free press.

2. HEALTH CARE

- (a) The provision of health care services to poor and needy persons.
- (b) The care or counselling of terminally ill persons or persons with a severe physical or mental disability, and the counselling of their families in this regard.
- (c) The prevention of HIV infection, the provision of preventative and educational programmes relating to HIV/Aids.
- (d) The care, counselling or treatment of persons afflicted with HIV/Aids, including the care or counselling of their families and dependants in this regard.
- (e) The provision of blood transfusion, organ donor or similar services.
- (f) The provision of primary health care education, sex education or family planning.

3. LAND AND HOUSING

- (a) The development, construction, upgrading, conversion or procurement of housing units for the benefit of persons whose monthly household income falls within the housing subsidy eligibility requirements of the National Housing code published pursuant to section 4 of the Housing Act, 1997 (Act No. 107 of 1997).
- (b) The development, servicing, upgrading or procurement of stands, or the provision of building materials, for purposes of the activities contemplated in subparagraph (a).
- (c) Building and equipping of clinics, crèches, community centres, sports facilities or other facilities of a similar nature for the benefit of the poor and needy.
- (d) The protection, enforcement or improvement of the rights of poor and needy tenants, labour tenants or occupiers, to use or occupy land or housing.

4. EDUCATION AND DEVELOPMENT

- (a) The provision of school buildings or equipment for public schools and educational institutions engaged in exempt activities contemplated in section 12(h) of the Value-Added Tax Act, 1991, for the benefit of the poor and needy and physically disabled.
- (b) Career guidance and counselling services provided to persons for purposes of attending any school or higher education institution as envisaged in section 12(h)(i)(aa) and (bb) of the Value-Added Tax Act, 1991.
- (c) Programmes addressing life skill needs of children at schools, pre-schools or educational institutions as envisaged in section 12(h) of the Value-Added Tax Act, 1991.
- (d) Educational enrichment, academic support, supplementary tuition or outreach programmes for the poor and needy.
- (e) Training for unemployed persons with the purpose of enabling them to obtain employment.

5. CONSERVATION, ENVIRONMENT AND ANIMAL WELFARE

- (a) Engaging in the conservation, rehabilitation or protection of the natural environment, including flora, fauna or the biosphere.
- (b) The care of animals, including the rehabilitation, or prevention of the ill-treatment of animals.
- (c) The promotion of, and education and training programmes relating to environmental awareness, greening, clean-up or sustainable development projects.

Annexure C – Extracts from the VATCOM Report on the government’s draft Value-Added Bill in regard to the VAT treatment of associations not for gain and welfare organisations

2.4 Association not for gain and a welfare organisation

An 'association not for gain' and a 'welfare organisation' are defined in clause 1. Special provisions in regard to the taxation of such associations and organisations are included in the Bill. Those provisions are summarised in paragraphs 15.4 and 15.5. The definition of 'association not for gain' includes religious and charitable institutions and some clubs. They are not exempt from tax merely by reason of their status or functions. Their treatment, however, differs in certain respects from the treatment of ordinary businesses. The definition of 'welfare organisation' includes any association not for gain which is registered as a welfare organisation under the National Welfare Act if it carries on certain activities circumscribed in the definition. The treatment of welfare organisations also differs in certain respects from the treatment of ordinary businesses and associations not for gain which do not qualify as welfare organisations.

15.4 Association not for gain

"Association not for gain" is defined in clause 1 to mean "any religious institution of a public character", or "any other society, association or organisation, whether incorporated or not" if it is carried on "otherwise than for the purposes of profit or gain to any proprietor, member or shareholder" and it has a written constitution in terms of which it must utilize its property or income solely in the furtherance of its aims and objects and is prohibited from transferring any portion thereof to any person other than in the form of bona fide reasonable remuneration to officers and employees for services actually rendered and, on its winding up or liquidation, its remaining assets after satisfaction of its liabilities have to be transferred to a similar society, association or organisation.

Besides a religious institution the definition may in the appropriate circumstances also include a charitable institution or a club.

An association not for gain which carries on an enterprise does not enjoy an exemption from tax on all the supplies made by it in the course or furtherance of any enterprise carried on by it. It will, however, enjoy the following advantages:

- (a) In terms of clause 12 (b) an exemption applies in respect of the supply by it of any donated goods or services or any other goods made or manufactured by it if at least 80 per cent of the value of the materials used consists of donated goods. "Donated goods or services" is defined in clause 1 to mean "goods or services which are donated to an association not for gain and are intended for use in the carrying on or carrying out of the purposes of that association."
- (b) A donation in cash voluntarily made to an association not for gain is not treated as consideration for a supply of goods or services if "no identifiable direct valuable benefit" arises in the form of such a supply (see the definitions of "consideration" and "unconditional gift" in clause 1). Voluntary contributions to church funds by members of the congregation would normally be of this description. Any payment made by a public authority or local authority is excluded from the definition of "unconditional gift" and it follows from the definition of "consideration" that a subsidy payable to an association not for gain will fall under that definition.
- (c) In terms of clause 23(5) separate registration of branches, divisions or separate enterprises of an association not for gain may be allowed if each branch, division or separate enterprise maintains an independent system of accounting and can be identified by reference to its activities or location. The turnover threshold of R150 000 per annum for registration provided for in clause 23(1) will then apply separately to each branch, division or separate enterprise. (Splitting of the threshold where separate registration of branches or divisions is effected under clause 50 in the case of any other person is not permissible.)

15.5 Welfare organisations

A "welfare organisation" defined in clause 5 to mean an association not for gain which is registered as a welfare organisation under the National Welfare Act, 1978 (Act 100 of 1978)", provided that that association's activities consist of "the provision of food, meals, board, lodging, clothing or other necessities, comforts or amenities to aged or indigent persons, children or physically or mentally handicapped persons".

As a "welfare organisation" is first and foremost an "association not for gain" it enjoys all the advantages of such an association (see paragraph 15.4). Whether a welfare organisation can enjoy further advantages depends on its specific circumstances and whether it is registered as a vendor or not.

15.5.1 Voluntary registration

A person can only apply for voluntary registration if he carries on an enterprise or intends to do so. In terms of paragraph (b)(ii) of the definition of "enterprise" in clause 1, the activities of a welfare organisation, namely the provision of food, meals, board, lodging, clothing or other necessities, comforts or amenities to aged or indigent persons, children or physically or mentally handicapped persons, amount to the carrying on of an enterprise. It is thus possible for a welfare organisation to apply for voluntary registration. Any other association not for gain which does not supply goods or services for a consideration in the course or furtherance of an enterprise, does not carry on an enterprise and can thus not apply for voluntary registration. The consequences of voluntary registration are:

- (a) An input tax deduction can be claimed in respect of tax paid in respect of goods or services acquired for welfare activities. Where, for example, a welfare organisation provides food or clothing to needy children it is deemed to be making taxable supplies even if no charge is made. Any tax paid in respect of the acquisition of that food or clothing can thus be claimed as an input tax credit. In so far as any payment is made for the supply of the goods or clothing, tax would be leviable on the amount of the payment.
- (b) State subsidies granted to welfare organisations are, in terms of clause 11(2)(n), subject to tax at the rate of zero per cent. In terms of this clause the services deemed by clause 8(5) to be supplied to a public authority or local authority are subject to tax at the rate of zero per cent if the services are supplied by a vendor which is a welfare organisation and the subsidy is received in respect of those activities of such organisation which amount to the carrying on of an enterprise as contemplated in paragraph (b)(ii) of the definition of "enterprise" in clause 1.

The implication of this is that the welfare organisation does not have to pay output tax in respect of any state subsidies but is nevertheless entitled to claim an input tax credit in respect of goods or services acquired for carrying on its welfare activities.

15.5.2 Compulsory registration

Although registration would normally be advantageous for a welfare organisation, especially as far as the recovery of input tax paid is concerned, registration requires that all the usual obligations of a vendor, such as the furnishing of returns and the levying of tax in respect of any taxable supplies made, be met by the welfare organisation. A welfare organisation is not, according to general principles, obliged to register as a vendor, unless the total annual value of its taxable supplies exceed R150 000.

As already stated, any subsidies paid by public authorities or local authorities to a welfare organisation are subject to tax at the zero rate. The proviso to clause 23(6) provides that in the case of a welfare organisation the value of such zero rated supplies need not be taken into account in determining the R150 000 registration limit.

A welfare organisation whose inputs, for example the acquisition of food, clothing and blankets, are chiefly financed by state subsidies or other unconditional gifts, will thus not be obliged to register if the total annual value of its taxable supplies exceeds R150 000 solely as a result of state subsidies it receives.

15.5.3 Other activities carried on by welfare organisations

In so far as a welfare organisation's activities do not comprise the provision of food, meals etc. to underprivileged persons, as contemplated in the definition of a welfare organisation, it does not qualify as a "welfare organisation" for VAT purposes. The payment of any state subsidy to such an organisation, in respect of the activities which do not comprise the carrying on of an enterprise, is subject to tax at the prescribed tax rate.

Where an organisation or association's activities can be divided between a profit-making division (e.g. a clothing factory) and a non-profit-making division (e.g. a welfare organisation), it will be treated as an "association not for gain" or "welfare organisation" only in so far as it complies with the requirements of the Bill in these regards. The normal principles in regard to registration and taxable supplies are applicable to the activities which amount to a profit-making organisation.