



# **Legal Counsel**

## **Value-Added Tax**

### **VAT 419**

#### **Guide for Municipalities**



*South African Revenue Service*

## Preface

This guide is a general guide concerning the application of the value-added tax Act (VAT in respect of municipalities in South Africa. Although fairly comprehensive, the guide does not deal with all the legal detail associated with VAT and is not intended for legal reference. Technical and legal terminology has also been avoided wherever possible. For details in respect of the general operation of VAT, see the *VAT 404 – Guide for Vendors* which is available on the South African Revenue Service (SARS) **website**.

All references to “the VAT Act” are to the Value-Added Tax Act 89 of 1991, and references to “sections” are to sections in the VAT Act, unless the context otherwise indicates. All references to “the TA Act” are to the Tax Administration Act 28 of 2011.

The terms “Republic”, “South Africa” or the abbreviation “RSA”, are used interchangeably in this document as a reference to the sovereign territory of the Republic of South Africa, as set out in the definition of “Republic” in section 1(1). The terms “Commissioner” and “Minister” refer to the Commissioner for SARS and the Minister of Finance respectively, unless otherwise indicated. A number of specific terms used throughout the guide are defined in the VAT Act. These terms and others are listed in the **Glossary** in a simplified form to make the guide more user-friendly.

The information in this guide is based on the VAT legislation (as amended) at the time of publishing, up to and including the –

- Taxation Laws Amendment Act 15 of 2016 (as per GG 40562 dated 19 January 2017); and
- Tax Administration Laws Amendment Act 16 of 2016 (as per GG 40563 dated 19 January 2017).

This guide is not an “official publication” as defined in section 1 of the Tax Administration Act and accordingly does not create a practice generally prevailing under section 5 of that Act. It is also not a binding general ruling under section 89 of Chapter 7 of the Tax Administration Act nor a ruling under section 41B of the VAT Act, unless otherwise indicated.

Operational information contained in this guide is up to date as at the date of publishing. However, always refer to the **SARS website** and any external guides specifically issued on such operational matters, which may be updated from time-to-time.

All guides, interpretation notes, forms, returns and tables referred to in this guide are available on the **SARS website** and are as at the date of this publication.

The following guides have also been issued and may be referred to for more information relating to the specific VAT topics:

- *Vendors and Employers: Trade Classification Guide* (VAT / EMP 403);
- *Guide for Vendors* (VAT 404)
- *Fixed Property and Construction* (VAT 409);
- *Guide for Entertainment, Accommodation and Catering* (VAT 411);
- *Guide for Share Block Schemes* (VAT 412);
- *Guide for Estates* (VAT 413);
- *Guide for Associations not for Gain and Welfare Organisations* (VAT 414);

- *Guide for Motor Dealers* (VAT 420);
- *Guide for Short-Term Insurance* (VAT 421); and
- *Quick Reference Guide on the VAT Ruling Application Procedure*.

Should there be any aspects relating to VAT which are not clear or not dealt with in this guide, or should you require further information or a specific ruling on a tax related legal issue, you may –

- visit the SARS website at **www.sars.gov.za**;
- contact your local SARS branch;
- contact the SARS National Call Centre –
  - if calling locally, on 0800 00 7277;
  - if calling from abroad, on +27 11 602 2093 (only between 8am and 4pm South African time);
- submit a ruling application to SARS headed “Application for a VAT Class Ruling” or “Application for a VAT Ruling” together with the VAT301 form by email to **VATRulings@sars.gov.za** or by facsimile on +27 86 540 9390; or
- submit legal interpretative queries on the Tax Administration Act by e-mail to **TAAInfo@sars.gov.za**; or
- contact your own tax advisors.

Comments regarding this guide may be emailed to **policycomments@sars.gov.za**.

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# Chapter 1

## Introduction

### 1.1. Scope of topics covered

The purpose of this guide is to provide guidance and clarity on the VAT treatment of supplies made by municipalities that are registered as VAT vendors.

As municipalities are treated, as far as possible, as ordinary VAT vendors with effect from 1 July 2006, the general VAT rules as set out in the *VAT 404 – Guide for Vendors* are applicable. Topics dealt with in sufficient detail in that Guide are therefore not repeated in this Guide unless it is for purposes of clarifying the VAT treatment of supplies made to, or by, municipalities.

### 1.2. Approach of this guide

The approach of this guide in dealing with the scope of topics is set out below.

**Chapter 1** – Sets out the policy framework and approach of the guide in relation to the VAT treatment of transactions involving municipalities covered in the guide.

**Chapter 2** – Introduces the reader to the most important VAT concepts, terms and definitions mentioned in the guide so that the VAT treatment of supplies explained in later chapters can be understood. Key points addressed in this chapter include an explanation of the terms “enterprise”, “municipality” and “grant”.

**Chapter 3** – Provides a brief overview of the legal concepts “agent” and “principal”. This is important as the VAT consequences of a transaction cannot be determined until the contractual relationship between the parties is established.

**Chapter 4** – Deals with how VAT should be accounted for in respect of the different types of supplies made by municipalities as well as the time of supply rules. The chapter sets out the general rules with regard to classifying supplies, record-keeping, invoicing and documentation required, including the VAT treatment of grants made to and by municipalities.

**Chapter 5** – Focuses on understanding input tax from a municipality’s perspective. The most important aspects include direct attribution, apportionment methodology, and the VAT treatment of entertainment and motor cars by municipalities.

**Chapter 6** – Deals with adjustments to output or input tax that may arise for municipalities that may result from a change in use, consumption or application of goods or services acquired by municipalities.

**Chapter 7** – Briefly addresses the VAT treatment of supplies unique to municipalities and covers those for which no direct consideration is charged, including metro police, agency services and the unfunded mandates of municipalities, foreign donor funded projects and the integrated rapid public transport networks.

## Chapter 2

### Definitions and concepts

#### 2.1 Accounting basis

The general rule is that all vendors are required to account for tax payable on the invoice basis. This means that a person has to declare output tax and deduct input tax in the tax period in which the time of supply in respect of a transaction occurs – regardless of whether payment for the supply has been made or received. However, the Commissioner may, upon application, allow a vendor to account for tax payable on the payments basis. Where the Commissioner allows a vendor to account for VAT on the payments basis, the vendor declares output tax and deducts input tax in the applicable tax period only to the extent to which payment of the consideration is received or made in that tax period, subject to certain exceptions.

In terms of the VAT Act, only certain categories of persons are allowed to account for VAT on the payments basis, for example –

- natural persons;
- partnerships consisting of only natural persons;
- public authorities;
- municipalities; and
- municipal entities which make supplies of water, electricity, gas and refuse removal.

In practice, most municipalities account for VAT on the payments basis. One of the reasons for this is that municipalities have a vast customer base to which they supply many types of goods or services. As the billing for the supply of water, electricity and refuse removal cannot be done in advance, municipalities often carry a large amount of debtors which have unpaid and arrear accounts in respect of these supplies.

#### Example 1 – Payments basis of accounting

*Facts:*

ABC Municipality accounts for VAT on a monthly basis (Category C tax period) using the payments basis of accounting. ABC Municipality supplies electricity to Mr V for an amount of R570 (including VAT) on 25 January 2015 and invoices Mr V for this amount on 28 February 2015. Mr V pays the amount to ABC Municipality in two equal instalments of R285 on 7 March 2015 and 7 April 2015 respectively.

*Result:*<sup>1</sup>

ABC Municipality must account for output tax for the payment received on 7 March 2015 in the tax period ending March 2015. The output tax to be declared in this tax period is R35 ( $R285 \times 14 / 114$ ). In addition, ABC Municipality must account for output tax for the payment received on 7 April 2015 in the tax period ending April 2015. The output tax to be declared in this tax period is R35 ( $R285 \times 14 / 114$ ).

<sup>1</sup> Only the output tax implications are dealt with here, but the same principle will apply in respect of any input tax that may be deducted. When goods or services are acquired in one tax period and only paid for in another tax period, it is only in the tax period in which payment occurs that the deduction of input tax will be allowed (limited to the extent of the actual payment made).

## 2.2 Time and value of supply

The purpose of determining the time of supply for goods or services is to determine when a supply takes place for VAT purposes. The time of supply therefore establishes the date and, as such, the tax period that the supplier is required to declare the VAT charged on any supply made. Conversely, it establishes the date and tax period that the recipient becomes entitled to deduct input tax on goods or services acquired (provided that the requirements of the Act for deducting input tax have been met).

The general rule for the time of supply is determined as being the date when an invoice is issued in respect of a supply, or the date that payment of the consideration for the supply is received, whichever date is the earlier. This general rule will apply in most cases, but some supplies have a special time of supply rule which may deviate from the general rule. For example, the time of supply for fixed property is the earlier of the date that any payment of the consideration for the supply is made to the supplier, or the date that the property is registered in the name of the purchaser in a deeds registry.

The payments basis (or cash basis) uses the same general time of supply rule mentioned above, but the vendor only accounts for VAT on actual payments made and actual payments received in respect of taxable supplies during the period.

The general rule for the value of supply is that it is equal to the price charged for the supply of goods or services less the VAT included in the price. Therefore, the value of the supply of goods or services is an amount that excludes VAT. The amount that includes VAT is referred to as “*consideration*”. The calculation of the value of supply and the consideration (including standard rated VAT charged at 14%) can be illustrated by using the formula:

$$\text{VALUE} + \text{VAT} = \text{CONSIDERATION}$$

*therefore*

$$\text{CONSIDERATION} - \text{VAT} = \text{VALUE}$$

As with the time of supply, there are also special rules that may apply in certain cases for determining the value of the supply or the consideration. The general value of supply rule, discussed above, does not apply where the taxable supply is made between connected persons if –

- the supply is made for no consideration, the consideration cannot be determined at the time of supply or for a consideration which is less than the open market value; and
- the purchaser is either not a vendor, or if registered for VAT, would not be entitled to deduct the full input tax credit in respect of that supply.

In such cases, VAT the supplier must account for VAT on the open market value of the supply. The term “open market value” includes VAT.

For more details on these special cases, see the *VAT 404 – Guide for Vendors*.

## 2.3 Enterprise

The term “enterprise” is of paramount importance in the context of the VAT Act, because –

- a person that does not conduct an enterprise cannot register for VAT;
- only supplies made in the course or furtherance of carrying on an enterprise (referred to as taxable supplies) are subject to VAT; and



- only the VAT on expenses incurred in the course or furtherance of an enterprise may be deducted as input tax.

See **Chapter 4** for further information.

### 2.3.1 Carrying on an enterprise

A person will generally be considered to be carrying on an “*enterprise*” if all of the following requirements are met:

- An *enterprise or activity* is carried on *continuously or regularly* by a person in the Republic or partly in the Republic.
- In the course of carrying on the enterprise or activity, *goods or services are supplied* to another person.
- There is a *consideration* payable for the goods or services supplied.

### 2.3.2 Non-enterprise activities

Specifically excluded from the definition of “enterprise” is any activity that involves the making of exempt supplies (see **2.8.2** for more information). A person that only makes exempt supplies will not be able to register for VAT.

Municipalities also receive payments in the form of fines and penalties imposed, or dividends from investments. Although not specifically exempt under section 12, these receipts are nevertheless non-taxable as they are not received in respect of any goods or services supplied and are referred to as “out-of-scope” receipts.

## 2.4 Registration

Persons who make taxable supplies in excess of R1 million in any consecutive 12-month period or will exceed that amount in terms of a contractual obligation in writing, are liable for compulsory VAT registration.<sup>2</sup> In cases where the value of taxable supplies is less than the registration threshold the person may apply for voluntary registration. See the *VAT 404 – Guide for Vendors* for more information.

Municipalities are not required to meet these minimum thresholds for registration and are able to register as vendors under section 23(3)(a).

## 2.5 Municipality

The definition of the term “municipality” in the VAT Act refers to the definition as contained in section 1 of the Income Tax Act 58 of 1962. That definition, in turn, makes reference to Category A, B and C municipalities as contemplated in section 155 of the Constitution of the Republic of South Africa, 1996 (the Constitution), which deals with the establishment of municipalities. These entities are organs of state within the local sphere of government exercising legislative and executive authority within an area determined in terms of the Local Government: Municipal Demarcation Act 27 of 1998.

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<sup>2</sup> From 1 June 2014 non-resident suppliers of certain electronic services to South African residents are also required to register for VAT from the end of any month in which the threshold of R50 000 has been exceeded.

The different types of municipalities are classified as follows:

**Category A:** A municipality that has exclusive municipal executive and legislative authority in its area.

**Category B:** A municipality that shares municipal executive and legislative authority in its area with a Category C municipality within whose area it falls.

**Category C:** A municipality that has municipal executive and legislative authority in an area that includes more than one municipality.

## 2.6 Municipal Entity

A “municipal entity” is an entity created by one or more municipalities to carry on certain activities which would otherwise be conducted by the municipalities concerned. As a municipal entity is a separate juristic person from the municipality which created it, it will have to register separately for VAT if it makes taxable supplies in excess of the compulsory VAT registration threshold. As a general rule a municipal entity does not conduct activities on behalf of a municipality, but rather for its own account. See 7.5 for more details on municipal entities.

## 2.7 Municipal Rate

A “municipal rate”<sup>3</sup> is a charge levied by a municipality on owners of property in the municipality’s demarcated area in terms of the Local Government: Municipal Property Rates Act 6 of 2004 (Rates Act). The charge is in *lieu* of facilities provided by the municipality to the general public in its area and in respect of which it does not, or is unable, to charge a specific consideration. For example, street lighting, municipal roads and gardens, cleaning of streets etc.

Since a municipal rate is charged for facilities and services provided to the general public, the term specifically excludes charges in respect of the supply of electricity, gas, water, drainage, removal or disposal of sewage or garbage; or goods or services that are incidental to, or necessary for making those supplies. It also excludes the situation where a municipality charges a single charge (a “flat rate” or an all-inclusive rate) for municipal rates and the supplies of goods or services mentioned above.

Charges for municipal rates are subject to VAT at the zero rate, but the zero rate does not apply when there is no separate charge for goods or services such as water and electricity.

## 2.8 Supply

The term is defined very broadly and includes all forms of supply and any derivative of the term, irrespective of where the supply is affected. The term includes performance in terms of a sale, rental agreement, instalment credit agreement or barter transaction. The term also includes voluntary supplies (for example, a donation of goods or services) and supplies that take place by operation of law (forced sales, expropriation etc).

Apart from the supplies mentioned above, section 8 also provides for certain “deemed supplies”. These deemed supplies include are events or transactions that are included in the meaning of “supply”.

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<sup>3</sup> See section 1(1).

For example –

- the receipt of a grant from a public authority for the purposes of making taxable supplies;
- the receipt of an indemnity payment under a contract of insurance; and
- assets retained for non-enterprise purposes when a vendor deregisters for VAT.

### 2.8.1 Taxable supply

The term “taxable supply” includes all supplies of goods or services made by a vendor in the course or furtherance of an “enterprise”. Section 7(1)(a) prescribes that VAT must be levied at the standard rate (currently 14%) on a taxable supply, except where the type of supply is listed in section 11, in which case VAT is levied at the zero rate (0%). (See **4.2.1** and **Annexure A** for examples)

### 2.8.2 Exempt supply

Exempt supplies are supplies set out in section 12 which are specifically exempted from VAT. The value of exempt supplies does not form part of the taxable turnover and is not used to determine whether a person is liable to register for VAT or not. If a person makes only exempt supplies, that person cannot register as a vendor for VAT purposes.

Examples of exempt supplies include –

- financial services (for example, interest on a loan);
- renting of a dwelling for use as a residence (excluding commercial accommodation); and
- transport of fare-paying passengers within South Africa by taxi, bus, or train.

## 2.9 Output Tax

Output tax refers to the tax levied at the standard rate by a vendor on the supply of goods or services. The output tax is determined by applying the VAT rate of 14% to the value of a supply of goods or services. In instances where the amount charged (consideration) for the supply of goods or services includes VAT, the output tax is determined by applying the tax fraction (14/114) to the consideration. For example, where the charge including VAT is R500, the output tax included in the amount is  $R500 \times 14 / 114 = R61.40$ .

See also **Chapter 4** for further information.

## 2.10 Input Tax

Input tax refers to the tax paid by a vendor on -

- the acquisition of goods or services that are to be consumed, used or supplied by that vendor either wholly or partly in the course of making taxable supplies; and
- the importation of any goods into the Republic.

Exempt supplies are not taxable supplies and therefore VAT may not be levied on such supplies. Similarly, input tax may not be deducted on any expenses incurred to make exempt supplies. If the person is registered for VAT and makes both taxable and exempt supplies, only the VAT incurred on any expenses to make taxable supplies may be deducted as input tax.

Input tax may be deducted by a vendor to the extent that goods or services are acquired for taxable purposes and the appropriate documentation is held, for example:

- VAT paid at the standard rate by a municipality on goods or services acquired from a vendor for taxable purposes.
- VAT paid to SARS Customs & Excise on the importation of goods into the Republic.
- Second-hand goods (including fixed property<sup>4</sup>) situated in the Republic acquired under a non-taxable supply from a resident of the Republic. (This is generally referred to as “notional input tax”.)

See **Chapter 5** for more details.

## 2.11 Adjustments

An adjustment normally arises because of a change in the extent to which goods or services are applied for taxable purposes. For example, an output tax adjustment must be made when goods or services acquired wholly for making taxable supplies are subsequently applied wholly for making exempt supplies. Similarly, when goods or services acquired wholly for exempt supplies are subsequently applied wholly for making taxable supplies, an input tax adjustment will be allowed on the change in use.

See to **Chapter 6** for more details.

## 2.12 Grant

A grant is generally subject to VAT at the zero rate if the grant is received for taxable purposes. The term “grant” refers to any gratuitous or unrequited payment by the grantor, where the recipient does not supply goods or services of corresponding value in return for the grant. Where there is an actual supply of goods or services by a recipient, the payment does not qualify as a “grant” as defined and any supply made in return for that payment will be subject to VAT at the standard rate (provided the supply concerned is a taxable supply).<sup>5</sup>

A grant excludes any payment made by the Department of Human Settlements to a vendor (including a municipality) under a national housing programme. (The potential zero-rating of such payments must be considered under sections 8(23) and 11(2)(s). Section 8(23) was due to be deleted with effect from 1 April 2017, however, in the annual Budget presented by the Minister in February 2017, it was proposed that the deletion will be delayed until 1 April 2019.)

See **4.5** for a detailed discussion on deemed supplies and the definition of a “grant”.

## 2.13 Municipal Standard Chart of Accounts

The acronym “mSCOA” is a reference to The Standard Chart of Accounts which was published in the form of Municipal Regulations in terms of the Local Government: Municipal Finance Management Act 56 of 2003. (Government Notice R. 312 published in *Government Gazette* 37577 dated 22 April 2014.) All municipalities and municipal entities will be required to implement mSCOA by 1 July 2017.

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<sup>4</sup> See the Binding General Ruling on documentary proof in relation to the deduction of input tax on importation for more clarity in this regard (At the time of issue of this Guide this publication was still in draft).

<sup>5</sup> See *CSARS v Marshall NO* (816/2015) [2016] ZASCA 158 (3 October 2016).

The *m*SCOA Regulations provide a uniform and standardised financial transaction classification framework. Essentially this means that *m*SCOA prescribes the method and format that municipalities and municipal entities should use to record and classify all expenditure (capital and operating), revenue, assets, liabilities, equity, policy outcomes and legislative reporting. The *m*SCOA system was developed by National Treasury to align with the requirements of the Municipal Regulations and will be made available to users through licenced system vendors.

The reason for implementing *m*SCOA is that currently municipalities and municipal entities work on different financial reporting systems. As such, there is no common or set standard. This makes matters difficult at a national level when it comes to generating meaningful and accurate information to compare the financial performance of municipalities and municipal entities across the different regions. Municipalities and municipal entities are also required to compile certain other reports which may be based on financial information or other information which needs to be retained.

For more information on *m*SCOA, see **4.6** as well as the National Treasury's website.

## Chapter 3

### Agent vs. principal

#### 3.1 Introduction

Before determining the VAT consequences of a transaction, it is necessary to establish the relationship between the parties. This is to determine if the vendor is acting as an agent on behalf of another person or as principal. Section 54 contains special provisions to deal with the VAT consequences arising from an agency relationship. This chapter aims to provide clarity regarding the VAT treatment of supplies where an agent/principal relationship exists and specific examples are provided to illustrate these concepts.

#### 3.2 Legal principles of agency

An agency is a contract under which one person (the agent) is authorised and required by another person (the principal) to contract or to negotiate a contract with a third person, on the latter's behalf. The agent in representing the principal, creates, alters or discharges legal obligations of a contractual nature between the principal and the third party. The agent therefore provides a service to the principal and normally charges a fee (generally referred to as "commission" or an "agency fee") but does not acquire ownership of the goods and/or services supplied to or by the principal.

This agent/principal relationship may be interpreted from the wording of a written agreement or contract concluded between the parties. Where a written agreement or contract does not exist, the onus of proof is on the agent who seeks to bind the principal in a contract to demonstrate that an agency agreement exists between the agent and another person who is the principal for the purposes of the supply. An understanding of the relationship between the parties is therefore a requirement in understanding the VAT treatment of supplies made by the parties.

In essence, where an agent/principal relationship exists, the principal is ultimately responsible for the commercial risks associated with a transaction and that the agent is trading for the principal's account. The agent is appointed by and takes instruction from the principal regarding the facilitation of transactions as per the principal's requirements and generally charges a fee or earns a commission for that service.

The VAT treatment of supplies proceeds from the fact of whether a person is acting on its own behalf, or on behalf of another person. In essence, section 54 provides that where a vendor employs the services of an agent to acquire goods or services, or to make supplies on the vendor's behalf, the VAT on the supplies concerned must be accounted for by the principal and not the agent. There are also special provisions dealing with the receipt and issuing of tax invoices. See 3.3 below.

#### 3.3 Tax invoices, credit notes and debit notes

The normal rule is that any tax invoice, credit or debit note relating to a supply by, or to the agent, on the principal's behalf should contain the principal's particulars. However, the VAT Act provides that if an agent (being a vendor) makes a supply on behalf of another vendor (the principal), the agent may issue a tax invoice or a credit or debit note relating to that supply as if the supply had been made by the agent. In such a case, the agent's details may be reflected on the tax invoice, credit or debit note. In these circumstances, however, the principal may not also issue a tax invoice or credit or debit note in respect of that same supply.

The VAT Act also makes provision for the agent to be provided with a tax invoice, credit or debit note as if the supply were made to the agent.

The agent must maintain sufficient records so that the name, address and VAT registration number of the principal can be ascertained, when a tax invoice, credit note or debit note has been issued by or to an agent in the circumstances described above.

In addition, the agent must submit a statement to the principal within 21 days of the end of each calendar month, notifying the principal of –

- a description of the goods or services supplied or received;
- the quantity or volume of the goods or services supplied or received; and
- either –
  - the value of the supply, the amount of tax charged and the consideration for that supply; or
  - where the amount of tax charged is calculated by applying the tax fraction to the consideration, the consideration for the supply and either the amount of tax charged, or a statement that it includes a charge in respect of the tax and the rate at which the tax was charged.

An agent acting on behalf of a vendor for the importation of goods must furnish the vendor with a statement under section 54(3)(b)(ii), read with section 54(2A), when the bill of entry or other document prescribed in terms of the Customs and Excise Act is issued in the name of the agent. The agent is required to give the principal this statement within 21 days of the end of the calendar month during which the goods were imported and it must contain the following particulars –

- a full and proper description of the goods imported;
- the quantity and volume of the goods imported;
- the value of the goods imported;
- the amount of tax paid on importation;
- the receipt number for the payment of the VAT on importation issued on eFiling; and
- an agreement in writing between the agent and principal confirming the identity of the parties and that the agent is importing the goods on behalf of the principal.<sup>6</sup>

In the circumstances where the bill of entry or other customs documents reflect the name of both the principal and the clearing agent, and the principal is in possession of these documents, the agent is not required to issue this statement.

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<sup>6</sup> See the Binding General Ruling on documentary proof in relation to the deduction of input tax on importation for more clarity in this regard (At the time of issue of this Guide this publication was still in draft).

### 3.4 Application of agency principles

In terms of the Constitution, national and provincial governments are mandated to perform activities in certain functional areas, for example, vehicle licensing, road traffic regulation, provincial roads and traffic and primary health care services. Municipalities have the right to administer certain local government activities, for example building regulations, fire-fighting services, municipal public transport, municipal roads, street lighting, traffic and parking, environmental health services, billboards and the display of advertisements in public areas.

National and provincial governments may assign, by agreement and subject to certain conditions, any of the activities mandated to them to a municipality, provided that the municipality has the capacity to administer it and the matter would be most effectively administered locally. In addition, the provincial government may appoint a municipality as agent to carry on certain activities where the provincial government may need assistance to carry out its mandated activities. See also to 7.3.

Based on the discussion under 3.2 and 3.3 above, it is imperative that agreements, usually referred to as Service Level Agreements (SLAs), are formalised between municipalities and provincial government where functions are assigned to municipalities, or where a municipality acts as agent of the national or provincial government to execute certain tasks. An understanding of the relationship between the parties is therefore a requirement in understanding the VAT treatment of a supply by a municipality, as the accounting for VAT follows from the role, function and contractual capacity in terms of which the parties to a transaction carry out their activities.

#### 3.4.1 Principal

In cases where a municipality has been assigned the responsibility of supplying certain goods or services (being taxable supplies) as principal –

- the activity and the supplies made will form part of the municipality's taxable activities, and the fees or other charges in respect of the supply of those goods or services will be reflected as the municipality's income which would be subject to VAT at either the standard rate of 14% or the zero rate; and
- the municipality is entitled to deduct input tax on the goods or services acquired for the purposes of making those taxable supplies.

Insofar as the municipality supplies exempt goods or services as principal, the amounts will also be reflected in the municipality's income but would not be subject to VAT. As such, the municipality will not be entitled to deduct input tax on goods or services acquired for the making of these supplies.

The following example illustrates circumstances in which municipalities act as principal in an agency relationship.

#### **Example 2 – Municipality acts as principal**

*Facts:*

Province Y is not a vendor and provides primary health care (PHC) services within Municipality X's demarcated area. Province Y's fees are based on a standard charge of R100 per patient. Municipality X is not involved in the provision of the PHC services itself, but rents a commercial building to Province Y for R20 000 per month (including VAT) from where the PHC services are supplied.



*Result:*

Province Y is not a vendor, therefore the fee of R100 charged to patients by Province Y will not attract VAT. Furthermore, Province Y may not deduct any VAT (input tax) on expenses incurred to provide the PHC services, for which it is the principal. Province Y will be charged VAT at the standard rate on the supply of the building by Municipality X under the rental agreement, as Municipality X is the principal in respect of the supply of the building to Province Y.

The VAT charged may not be deducted as input tax by Province Y since it is not a vendor. Province Y must therefore budget on the basis that any VAT incurred in connection with the provision of PHC services is an accounting and actual “cost”. Municipality X must declare output tax at the standard rate ( $R20\,000 \times 14 / 114 = R2\,456.14$ ) on the rental received for the supply of the building and it may deduct input tax on the VAT-inclusive expenses incurred on maintaining the building.

**Example 3 – Township development: Municipality acts as principal***Facts:*

Municipality A budgeted R10 million for its own township development project. The project involves the erection of a number of townhouses and supporting infrastructure in a newly proclaimed township within its jurisdiction. The townhouses will be marketed to middle class purchasers. Municipality A will sell the townhouses for a total of R12 million. Municipality A receives a municipal infrastructure grant of R8 million from National Treasury to assist it to develop the township.

*Result:*

The R8 million received is a “grant” and the receipt is subject to VAT at the zero rate as National Treasury does not receive any goods or services in return for the payment. The sale of townhouses constitutes taxable supplies and therefore Municipality A will have to charge VAT at the standard rate on the sale of the units. The VAT-inclusive costs of developing the townhouses may be deducted as input tax provided the relevant supporting documentation is obtained and retained.

**Example 4 – Sub-contracting of municipal services***Facts:*

Municipality A is required to perform refuse removal services in its demarcated area, but due to a strike by municipal employees, it does not have the capacity to carry out this responsibility for the months of July and August 2015. Municipality A enters into an agreement with RG CC (a private contractor and a vendor) to perform the services on its behalf for the period. Municipality A continues to issue tax invoices to its clients as normal, even though it subcontracted the performance of the refuse removal itself to another person.

*Result:*

RG CC must account for output tax on the amount charged to Municipality A for performing the refuse removal services.

Municipality A is the principal for the purposes of the supply of refuse removal services to its customers. It must therefore account for output tax on the full consideration charged, as it would have done, had it actually performed the services itself. The VAT charged by RG CC may be deducted as input tax by Municipality A, as the expense is incurred in the course of Municipality A's enterprise activities.

**3.4.2 Agent**

A municipality generally acts as an agent when assisting the provincial government to deliver on its mandate, in which case the following applies:

- The actual fees charged by the municipality, as agent on behalf of the provincial government in respect of the underlying supply, will not be subject to VAT. The reason for this is that the provincial government is a "public authority" and as a general rule may not register for VAT, or charge VAT on goods or services supplied (unless that public authority is notified by the Minister to register for VAT).
- The municipality must account for output tax at the standard rate of 14% on the commission or agency fee and any other charge made for the supply of the agency services (for example, issuing licenses or permits on behalf of the provincial government).
- Any VAT charged by the municipality on the agency fee/commission and any other elements of consideration charged (or cost recoveries made) by the municipality cannot be deducted as input tax by the provincial government as it is not a vendor. The VAT charged by the municipality therefore becomes part of the overall costs incurred by the provincial government for providing the goods or services and should be budgeted for accordingly.

The following examples illustrate circumstances in which municipalities act as an agent.

**Example 5 – Vehicle licence: Municipality acts as agent for provincial government***Facts:*

Province Y enters into an SLA in terms of which Municipality X is appointed to collect vehicle licence fees and to issue vehicle licences on its behalf.

*Result:*

The vehicle licence fees charged by Municipality X, as agent on behalf of Province Y, are not in respect of a taxable supply. The agency fee charged by Municipality X to Province Y for collecting the vehicle licence fees and issuing the licences on Province Y's behalf is a taxable supply at the standard rate. Municipality X will be entitled to deduct input tax in respect of any goods or services acquired in order to perform the agency services, (for example, computer systems maintenance, stationery, office rental, electricity etc).

The vehicle licence fees are charged by Municipality X as agent and do not constitute consideration charged in respect of a taxable supply. As Province Y is not a vendor, any VAT incurred on Municipality X's agency fee and any expenses incurred by Municipality X in acquiring goods or services on Province Y's behalf relating to the vehicle licence activity, cannot be deducted as input tax. The VAT is therefore a cost to Province Y.

### **Example 6 – Provincial administration building development: Municipality acts as agent**

*Facts:*

Province B engages Municipality A to act as its agent in overseeing and managing the activity of erecting a new provincial administration building. Municipality A charges a 4% VAT-inclusive fee (R400 000) based on the total development cost of R10 million.

Municipality A also pays the following expenses on Province B's behalf:

Roads, water and other infrastructure	R2 600 000 (including VAT)
Construction cost of provincial administration building	R5 000 000 (including VAT)
Provincial government employee salaries and wages	R2 000 000 (no VAT included)

*Result:*

Municipality A must account for output tax of R49 122.81 in respect of the R400 000 VAT-inclusive agency fee charged to Province B for overseeing and managing the project on Province B's behalf. Municipality A is only entitled to deduct input tax on its own expenses incurred that relate to its oversight and management of the project on behalf Province B. The VAT incurred in respect of the development of the provincial administration building as well as the agency fee charged by Municipality A is a cost to Province B. The VAT charged will also be a cost for Province B if the land for the development was acquired from a vendor. If the land was acquired from a non-vendor, Province B (being part of government) will be exempt from transfer duty.

In this example, if Municipality A merely disbursed the salaries and wages from funds advanced by Province B, it does not constitute part of the consideration charged for the agency services of Municipality A.

**Notes:**

Had Province B requested Municipality A to use its own employees to carry out the development, the salaries and wages paid by Municipality A to its own employees cannot be regarded as a disbursement on behalf of Province B, but an expense incurred in rendering a service. This is because the provision of labour by Municipality A would constitute a taxable supply and the consideration charged would attract VAT at the standard rate (regardless of the fact that the consideration is determined on the basis of a recovery of Municipality A's "costs").

Had this been the case, the "cost" of R2 000 000, in this case represents the actual salaries and wages paid by Municipality A to its own employees, it would have to charge an additional amount of R280 000 VAT (for example  $14\% \times R2\,000\,000$ ). This amount must appear on the tax invoice that must be issued to Province B, in addition to the agency fee. In the event that the municipality fails to raise output tax on the salary costs charged, the output tax which has to be declared on the supply would be a cost to Municipality A instead of Province B as the amount charged would be deemed to be inclusive of VAT.

This example illustrates how important it is to carry out the budgeting exercise correctly for projects of this nature.

**3.4.3 Both principal and agent**

It is possible for a municipality to act as both principal and agent. Whether this arises depends entirely on the circumstances at hand, but a municipality cannot act as both agent and principle in respect of the same supply.

The following example illustrates circumstances in which municipalities act as both principal and agent:

**Example 7 – Municipality acts as agent and principal for different supplies***Facts:*

Province Y provides PHC services within Municipality X's demarcated area. Province Y's fees are based on a standard charge of R100 per patient. Municipality X acts as the agent of Province Y in overseeing and managing the PHC activity on behalf of Province Y, and rents a commercial building to Province Y for R20 000 per month (including VAT) from where the PHC services are supplied.

Municipality X calculates the fee for the agency service at 30% of the charge per patient per month by Province Y.

*Result:*

Province Y is not a vendor, so when the fee of R100 is charged to patients by Province Y, no VAT may be charged. Furthermore, Province Y as principal and a non-vendor may not deduct any VAT (input tax) on expenses incurred to provide the PHC services, for which it is the principal.

Municipality X will charge VAT at the standard rate on the supply of the building to Province Y under the rental agreement, as Municipality X is the principal in respect of the supply of the building to Province Y. Municipality X will also charge VAT on its agency fee of R30 ( $R100 \times 30\%$ ) per patient per month. (The SLA should determine whether the 30% includes VAT, or whether it must be added.) The fact that Municipality X chooses to base the calculation of its agency fee (consideration) on a VAT-exclusive amount (R100), does not change the fact that the agency services constitute a taxable supply.

This VAT charged by Municipality X may also not be deducted as input tax by Province Y. It follows that Province Y must budget on the basis that any VAT incurred in connection with the provision of PHC services is an accounting and actual “cost” of Province Y.

Municipality X must declare output tax at the standard rate ( $R20\,000 \times 14 / 114 = R2\,456.14$ ) on the rental received for the supply of the building and the commission charged. It may deduct input tax on the VAT-inclusive expenses incurred on maintaining the building and managing the PHC services.

## Chapter 4

### Types of supplies

#### 4.1 Introduction

Municipalities have the right, under section 156(1)(a) of the Constitution, to administer certain local government activities listed in Part B of Schedule 4 and Part B of Schedule 5 to the Constitution (see **Annexure B**.) Municipalities are therefore involved in making many different types of supplies.

For the purposes of completing the VAT 201 return and accounting for VAT, it is necessary for a municipality to split the receipts in connection with its activities into –

- standard rated taxable supplies (electricity, water, refuse removal and supplies which are taxable at the standard rate with effect from 1 July 2006 – see **Annexure A** for examples);
- zero-rated supplies (for example, municipal rates charges and grants received for the purposes of making taxable supplies);
- exempt supplies (rental of dwellings and transport of fare-paying passengers by road or rail); and
- “out-of-scope” supplies and non-supplies (for example, fines and penalties).

These distinctions are set out in **4.2** to **4.5** below.

Receipts in respect of exempt supplies and other non-taxable receipts must be added together and reported as a single amount in Block 3 of the VAT 201 return.

#### 4.2 Taxable supplies

VAT must be levied at either the standard rate or the zero rate on a taxable supply (See **2.8**). Most of the supplies made by a municipality constitute taxable supplies. (See **Annexure A** for examples.)

##### 4.2.1 Standard-rated supplies

Standard-rated supplies are mentioned in **2.8.1**. See **Annexure A** for examples.

The following example illustrates the application of the standard rate of VAT to certain goods or services supplied by a municipality.

#### **Example 8 – Supplies made to the general public**

*Facts:*

Municipality A provides the following to the general public:

- Street lighting.
- Municipal roads.
- Fire brigade services.
- Parks and recreational facilities.

*Result:*

As the supply of these goods and services are not specifically exempt or zero-rated in terms of the VAT Act, they constitute taxable supplies at the standard rate and form part of Municipality A's "enterprise". Municipality A must account for output tax at the standard rate on any consideration charged for these supplies. It follows that input tax may be deducted by Municipality A when any VAT is incurred on goods or services acquired in order to make these supplies.

**4.2.2 Zero-rated supplies**

The zero rate of VAT will be applicable, if a municipality supplies any of the goods or services listed in section 11. This is subject to the requirement that documentary proof substantiating the municipality's entitlement to apply the zero rate, is obtained and retained.

The supply of services for which a municipal property rates are levied in terms of the Rates Act, are subject to VAT at the zero rate. See 2.7 for more information on municipal property rates.

The deemed supply which arises when a grant is received from a public authority, another municipality or a constitutional institution for the purpose of making taxable supplies is also zero-rated. Examples include equitable share and Sector Education and Training Authority (SETA) training grants which are for taxable purposes.

See 4.5.2 and 7.4 for more information on this aspect.

**Example 9 – Municipal property rates***Facts:*

Municipality D issues a tax invoice for the following supplies made to Mr K:

Rates on property	R450
City cleaning charge – domestic	R 20
Waste removal charge – domestic	<u>R 10</u>
	<u>R480</u>

*Result:*

Property services in respect of which municipal rates are charged are zero-rated under section 11(2)(w), Municipality D will account for a zero-rated consideration of R450. However, as the city cleaning and waste removal charges are levied in respect of separate standard rated supplies, Municipality D must account for VAT at the standard rate on those services ( $R20 + R10 = R30 \times 14 / 114 = R3.68$ ).

**4.2.3 Flat rate charge for single supply of goods and/or services**

Normally where a single consideration is charged for various supplies in respect of which different tax rates apply, section 8(15) requires a split to be made in the consideration so that tax can be levied correctly on each part of the consideration relating to the individual supplies. However, this rule does not apply to municipal rates charges. Therefore, where a municipality charges a single consideration (referred to as a "flat rate") and the charge is in respect of municipal property rates and other goods or services such as electricity, gas, water, drainage or the removal or disposal of sewage or garbage, the flat rate charge for all services is taxable at the standard rate.

Although the VAT Act provides for this situation, in practice, municipalities no longer apply this method of service delivery and billing.

### 4.3 Exempt supplies

As mentioned in 2.3, the activities of making exempt supplies are specifically excluded from the definition of “enterprise” will not be subject to VAT. Accordingly, no output tax must be levied on exempt supplies made and input tax may not be deducted on any expenses incurred to make those supplies.

Examples of exempt supplies made by municipalities include –

- interest earned on credit balances of municipal funds in a bank account or interest earned on investments;
- rental income earned on the supply of a dwelling under a rental agreement; and
- fares earned in respect of the supply of public passenger transport services in the Republic by bus or by train.

#### Example 10 – Standard-rated and exempt supplies

##### *Facts:*

Municipality E receives the following amounts from activities carried on for the month ended January 2015:

Public passenger transport (bus service)	R1 000 000
Signage and advertising on buses/bus shelters	R 250 000
Interest received – water and electricity debtors	R 100 000
Interest received – investment held at ABC Bank	R 10 000

##### *Result:*

Municipality E will account for an exempt amount of R1 110 000 (R1 000 000 + R100 000 + R10 000) in Block 3 of the VAT 201 return in respect of the income from public passenger transport and the interest received. However, the consideration of R250 000 received in respect of signage and advertising on buses and bus shelters is earned in respect of a taxable supply at the standard rate. Municipality E must therefore account for output tax of R30 701.75 ( $R250\,000 \times 14 / 114$ ) in Block 1 of the VAT 201 return.

### 4.4 Other non-taxable supplies and receipts

A municipality may also receive other payments which are non-taxable, for example –

- receipts which are not in respect of a supply falling within the ambit of the VAT Act; or
- receipts which are not in respect of any supply of goods or services made by the municipality.

These receipts are sometimes called “out-of-scope” receipts and are not subject to VAT at either the standard rate (14%) or the zero rate (0%), nor are they exempt under section 12 of the VAT Act.

Examples include –

- statutory fines and penalties which are regulated in terms of statute, such as, fines for speeding, parking violations, littering, late return of library books etc;



- any grants (including capital grants) received for the purpose of making exempt supplies or other non-taxable supplies;
- any donations (unconditional gifts) from charities or inheritances from individuals, provided there is no *quid pro quo* consisting of a supply of goods or services in return for the donation or inheritance to that person (or a connected person in relation to that person); and
- dividends received.

Municipalities must also distinguish between non-taxable amounts received for their own benefit and those amounts received on behalf of other persons. For example, a municipality may supply the service of collecting licence fees for the province and retain a certain amount as a collection fee. In such a case, the fee retained is in respect of a taxable supply made by the municipality. The licence fee itself is for the benefit of the province and not the municipality.

See **Chapter 3** for more details on this topic.

## 4.5 Deemed supplies arising from grants

### 4.5.1 Introduction

A “grant” as defined in section 1(1) is a gratuitous or “unrequited” payment by the grantor. Where the recipient is required to perform minor actions concerning the grant, such as providing the grantor with a report on how the grant funds were spent, those actions are not regarded as an actual taxable supply of “services” by the grantee to the grantor.

For example, when a municipality receives its equitable share grant, to the extent that the funds are in support of the taxable activities of the municipality, that municipality is deemed to make a supply to the Department that makes the payment. All the municipality does in that case is to use those funds to carry out its constitutional functions within the local sphere of government. There is no actual supply of goods or services to the Department in return for that payment. However, where a Department pays the municipality to make an actual supply of electricity or water to the Department (public authority), or to supply actual services, for example, to collect vehicle licence fees on behalf of a Provincial Department, the payment of commission in that regard does not constitute a “grant” in the hands of the municipality. Similarly, where a municipality makes a payment to a private vendor, that receipt will not constitute a “grant” if it is in fact payment for any goods or services actually supplied by that vendor to the municipality. For example, if a municipality pays a vendor an amount every month to clean the beaches within the municipality’s demarcated boundary, the payment to that vendor is not unrequited and can therefore not qualify as a “grant”. It is clearly a payment for services rendered (being the cleaning of the beaches) and VAT on the consideration paid or payable for those services must be charged at the standard rate.

All municipalities are required to procure goods or services in accordance with Part 1 of Chapter 11 of the Municipal Finance Management Act 56 of 2003 (the MFMA) which requires the application of Supply Chain Management (SCM) Regulations, the Municipal SCM Model Policy and other policy documents such as practice notes and circulars issued by National Treasury in this regard. Any payment made to a vendor in terms of these procurement procedures therefore constitutes consideration for the acquisition of goods or services by a municipality and does not qualify as a grant. This includes any payment to a municipal entity. (See **7.5**)

For a further detailed explanation on actual supplies versus deemed supplies, see *CSARS v Marshall NO* (816/2015) [2016] ZASCA 158 (3 October 2016). In this case, the Supreme Court of Appeal had to decide if VAT was payable at the standard rate on the actual supply of certain air rescue services provided by a welfare organization to the provincial government as contended by the Commissioner for SARS. Alternatively, if the effect of the contract was to give rise to a deemed supply of services under section 8(5) which meant that the services would be subject to VAT at the zero-rate under section 11(2)(n), as contended by the Appellant. The court held that section 8(5) of the VAT Act does not apply to the actual supply of services and therefore the payment did not qualify to be zero-rated under section 11(2)(n).

A payment is therefore **not** a zero-rated “grant” where –

- it constitutes payment for the actual supply of goods or services by the person making the payment;
- it constitutes a conditional loan which must be repaid to the lender either in the form of money, or in the form of a supply of goods or services upon the happening of a future event;
- the payment is made in exchange for the supply of shares in a public entity, municipal entity or other juristic person;
- the grantor pays a supplier of taxable goods or services directly on behalf of the grantee instead of paying the grant amount to the grantee.

#### 4.5.2 Grants to municipalities

Services are deemed to be supplied under section 8(5A) to the extent that a grant is received by a municipality from a public authority, constitutional institution, or another municipality. This deemed supply is zero-rated under section 11(2)(t), provided that the grant is for the purpose of assisting the municipality to make taxable supplies of goods or services in the course of its enterprise. If a grant is received for the purposes of exempt or other non-taxable purposes, it does not result in a deemed supply under section 8(5A). Consequently, the municipality will not be entitled to deduct any input tax in respect of any goods or services acquired to carry on the non-taxable activities for which those funds were intended.

A “*grant*” must be attributed and declared on the VAT 201 return according to whether the payment relates to taxable, exempt or other non-taxable supplies. If the grant is for both taxable and non-taxable purposes, the receipt must be attributed accordingly. For example, if 30% of a grant is for subsidising the municipality’s public transport business (exempt supply) and 70% is for subsidising the supply of water and electricity to customers (taxable supplies), 30% of the grant will not be taxable and the other 70% will be subject to VAT at the zero rate. It is important to correctly reflect whether a grant is zero-rated (Block 2) or exempt/out-of-scope (Block 3) on the VAT 201 return as it affects the apportionment calculation as discussed in 5.2.

The table below and on the following page lists some examples of the different types of grants which may be made by national or provincial government to municipalities, and includes details of their respective purposes. The examples are extracted from public documents issued by National Treasury and are provided for illustrative purposes only. As discussed in 4.5.1, the VAT implications of receiving the listed grants as well as any other grants received from national or provincial government will depend on whether the purpose for which the grant is received is to make taxable supplies or not.

The details of the grants may also differ from year to year as government changes the conditions for which the grants are provided, or when grant types are withdrawn or new types are introduced.

#### Examples of grants made to municipalities by government

Grant	Purpose
<b>Municipal Systems Improvement Grant</b>	To assist municipalities in building in-house capacity to perform their functions and stabilise institutional and governance systems as required in the Municipal Systems Act <sup>7</sup> and related legislation, policies and the local government turnaround strategy.
<b>Local Government Financial Management Grant</b>	To promote and support reforms in municipal financial management by building capacity to implement the Local Government: Municipal Finance Management Act.
<b>Electricity Demand Side Management Grant</b>	To provide subsidies to municipalities to implement Electricity Demand Side Management in municipal infrastructure in order to reduce electricity consumption and improve energy efficiency.
<b>Water Service Operating Subsidy Grant</b>	To subsidise and build capacity in water schemes owned and/or operated by the Department of Water Affairs (DWA) or by other agencies on behalf of the DWA and to transfer these schemes to local government.
<b>Municipal Infrastructure Grant (MIG)</b>	To provide specific capital finance for basic municipal infrastructure backlogs for poor households to micro enterprises and social institutions servicing poor communities.
<b>Integrated National Electrification Programme (INEP) (Municipal) Grant</b>	To implement the INEP by providing capital subsidies to municipalities to address the electrification backlog of permanently occupied residential dwellings, clinics and the installation of bulk infrastructure and the rehabilitation and refurbishment of electricity infrastructure to improve supply quality.
<b>Neighbourhood Development Partnership Grant (Capital Grant)</b>	To support neighbourhood development projects that provide community infrastructure and create the platform for other public and private sector development, towards improving the quality of life of residents in targeted underserved neighbourhoods (townships generally).
<b>Public Transport Infrastructure and Systems Grant</b>	To provide for accelerated planning, construction and improvement of public transport and non-motorised transport infrastructure and systems.
<b>Rural Roads Asset Management Grant</b>	To assist rural district municipalities to set up rural Road Asset Management Systems, and collect road and traffic data in line with the Road Infrastructure Strategic Framework for South Africa.

<sup>7</sup> Local Government: Municipal Systems Act 32 of 2000.

Grant	Purpose
<b>Equitable Share Grant</b>	<p>This grant is determined in terms of a formula and is paid annually in three tranches in terms of the Division of Revenue Act and in accordance with section 214 of the Constitution. The formula is based on various factors such as the number of households in a municipality’s demarcated area and the poverty level or demographic profile of the residents.</p> <p>Although the funds are generally regarded as being allocated on an unconditional basis, section 277 of the Constitution provides that a municipality is entitled to the equitable share so that it may “<i>provide basic services and perform the functions allocated to it.</i>” It is therefore expected that municipalities will utilise these funds to provide and maintain basic facilities for the operation of local government and that they will provide an essential minimum package of services to all indigent households on a sustainable basis.</p>

#### Example 11 – Zero-rated and out-of-scope grants received by a municipality

##### *Facts:*

On 1 August 2015, National Treasury (a public authority) makes a payment of R5 000 000 to Municipality B in terms of the Division of Revenue Act to enable Municipality B to construct a dam. In constructing the dam, Municipality B incurs construction costs, which include VAT at the standard rate. The Department of Transport (a public authority) also pays R200 000 to Municipality B to subsidise the provision of a bus service (passenger transport) in Municipality B’s demarcated area.

##### *Result:*

Municipality B does not supply any actual goods or services to National Treasury or to the Department of Transport in return for the payments. However, a deemed service arises in respect of the receipt of the R5 000 000 grant payment from National Treasury under section 8(5A). The deemed supply concerned is zero-rated under section 11(2)(f) as the funds will be used for taxable purposes. The VAT incurred on the construction costs in building the dam may therefore be deducted as input tax. However, no deemed supply arises in respect of the R200 000 received from the Department of Transport as the funds will be used for exempt purposes. Municipality B will reflect this amount as an out-of-scope receipt in Block 3 of the VAT 201 return.

### 4.5.3 Grants made by municipalities

A municipality may make a payment to another vendor which will qualify as a zero-rated “grant” in the hands of the recipient. The same rule as discussed in 4.5.1 applies, while remembering that in order to constitute a grant the amount paid should not constitute payment for the actual supply of goods or services, or be a payment to a “*designated entity*”<sup>8</sup> such as a municipal entity.

Since a municipality is not a grant-making institution, any grant by a municipality will be an exceptional item rather than something that occurs frequently in the normal course of

<sup>8</sup> See to section 8(5) and the definition of “designated entity” in section 1(1).

conducting an enterprise. It follows that an amount paid by a municipality to another person will more than likely constitute consideration for an actual supply, rather than an unrequited or gratuitous payment which qualifies as a “grant” as defined.

For example, if a municipality makes a payment to a public benefit organisation (vendor), that amount may qualify as a grant if the payment is unrequited in accordance with the conditions of section 67 of the MFMA. This means that the municipality does not expect (or receive) anything in the form of a supply of goods or services in return for that payment. On the other hand, if a payment is in fact consideration for the acquisition of goods or services by the municipality, or is payment for a taxable supply to a third person, the payment will not qualify as a zero-rated grant. This will apply even if the payment is said to have been made under section 67 of the MFMA. In this regard, each case must be tested against the facts to determine whether it is truly gratuitous before the zero rate of VAT can be applied by the recipient. Furthermore, words such as “grant”, “subsidy”, “grant-in-aid” or “intergovernmental grant” are sometimes used in a contract to describe payments made to the contracting party to perform activities which have been outsourced by a municipality.

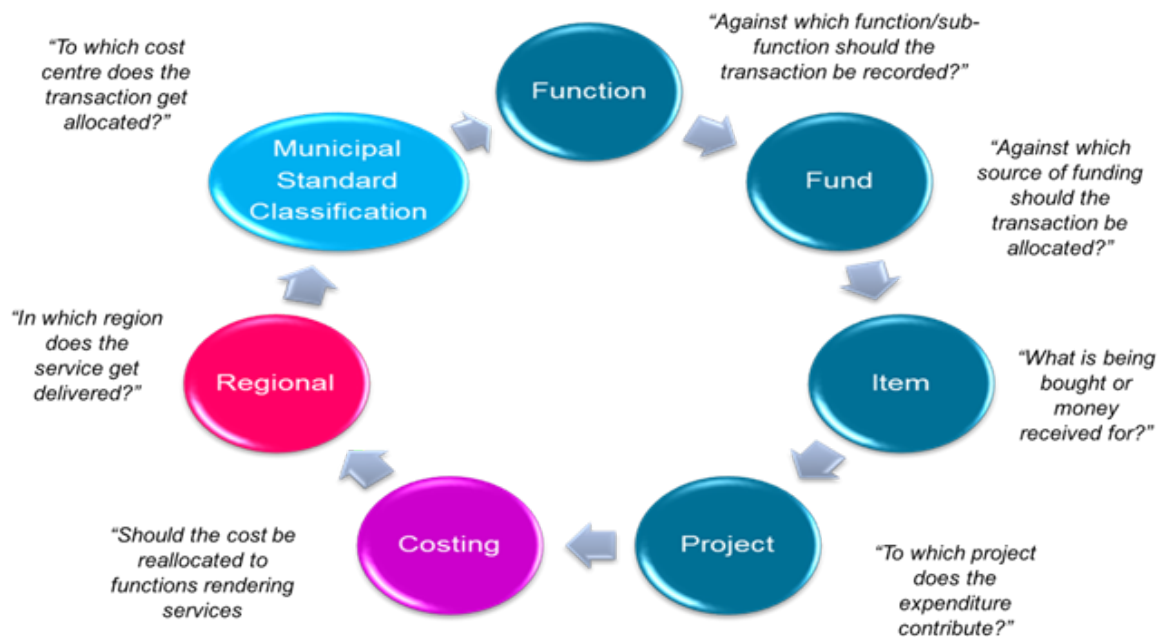
It is therefore clear that for the reasons mentioned above, and as described in **4.5.1**, certain payments are not gratuitous or unrequited and will not meet the definition of “grant”. A payment made in terms of such a contract will also not qualify as a zero-rated “*grant*” for VAT purposes merely because it has been called a grant by the contracting parties. Once again, each case must be evaluated on its own merits to establish whether the recipient is required to supply any goods or services in return for the payment.

For a detailed explanation regarding the VAT treatment of grants, see Interpretation Note 39 “VAT Treatment of Public Authorities and Grants”.

## **4.6 Overview of the Municipal Standard Chart of Accounts**

With effect from 1 July 2017 municipalities and municipal entities will be required to implement *mSCOA*. (See **2.13.**) The *mSCOA* system uses information relating to a transaction to determine the classification of accounts according to seven different segments. A “segment” is an activity of an entity that generates economic benefits or service potential regularly reviewed by management for the purpose of assessing its performance, and making decisions about the allocation of resources to the activity. (This can also include economic benefits or service potential relating to transactions between activities, departments or divisions of the same entity). Separate financial information must be available for a segment to be useful for decision-making purposes.

The seven segments are illustrated below:<sup>9</sup>



2

The details supporting the *mSCOA* segments are in the form of prescribed tables with descriptions within a large spreadsheet containing all possible accounts and sub-accounts to which a user can subscribe. Users can also add further sub-accounts as required down to posting level.

As not all municipalities and municipal entities will have a need for all possible accounts in the *mSCOA* system, users will only unlock those particular accounts and sub-accounts which are appropriate in the circumstances. For example, if a district municipality does not supply water, it will have no need to unlock the segment accounts that relate to the supply of water, nor those that relate to bulk water purchases. However, every transaction entered into by a user must be classified within each of the seven applicable segments and associated accounts and sub-accounts that the user has unlocked. The correctness of a transaction posting can be checked with reference to the preceding sub-accounts, accounts and segments used to classify the transaction.

Accounts will also have a "VAT status" indicator which will provide some guidance to users as to what the most likely VAT outcome of a transaction will be down to a certain sub-account level. (For example, standard rated output tax, zero-rated output, exempt supply, no deduction, deduct full input tax or apportionment etc.) The VAT indicators cannot, however, be regarded as prescriptive, mainly because it is not possible to embed the complex decision-making process and analysis of the facts of each transaction into the *mSCOA* system. Despite this, some general guidance can be provided, considering the structure of the account classifications within the different segments, the different activities conducted by municipalities, and the general application of VAT principles to municipalities.

As the VAT indicators in the *mSCOA* system are for guidance only, it will be possible for users to change the VAT indicators, based on the circumstances of the municipality and the details of the transaction concerned. However, when the coding in the system is changed, the user must provide a description or explanation in the posting level of the account.

<sup>9</sup> Source: Presentation by National Treasury: Chief Directorate Local Government Budget Analysis, 2014.

Although the *mSCOA* system will provide some guidance on the VAT treatment of transactions, this does not mean that the user does not have a responsibility to determine the final and correct VAT status of a transaction at posting level. For example, Municipality A may be able to attribute a telephone expense directly to a particular function within a department that only makes taxable supplies. This means that, in principle, the full amount of input tax may be deducted. However, in Municipality B the same expense may be attributable to the same function, but if the department that carries on that function makes both taxable and non-taxable supplies, the outcome may be that an apportionment of input tax is required in that case. One can therefore not rely solely on the VAT indicators to determine the final outcome on the VAT treatment as each municipality has different circumstances which must be taken into account when classifying the expense.

For more information on *mSCOA*, see **2.13** as well as the National Treasury's website [www.treasury.gov.za](http://www.treasury.gov.za).

## Chapter 5

### Input tax

#### 5.1 Introduction

In order for a municipality to deduct input tax, goods or services must be acquired for the purpose of consumption, use or supply in the course of making taxable supplies. No input tax may be deducted in respect of goods or services acquired for the purposes of making exempt or other non-taxable supplies.

Input tax may therefore be deducted on acquisitions for taxable purposes where –

- VAT is charged at the standard rate by a VAT-registered supplier of goods or services;
- VAT is paid on the importation of goods into the Republic; or
- second-hand goods situated in the Republic (including fixed property) are acquired under a non-taxable supply from a resident of the Republic.

There are, however, a number of conditions to be met in addition to the above, namely –

- the recipient must be in possession of the relevant documentation, for example, a tax invoice or a bill of entry (together with a receipt issued by Customs for the payment of the VAT on importation, the EDI Status 1 Release Message and, the statement issued by the agent under section 54(3)(b)(ii) read with section 54(2A));<sup>10</sup>
- where goods or services are acquired only partly for the purpose of making taxable supplies, an apportionment of input tax must be made; and
- no input tax may be deducted where the goods or services are acquired for making exempt or other non-taxable supplies, or where the input tax is specifically denied under section 17.

There are a number of other limitations and conditions that apply when second-hand goods are acquired under a non-taxable supply, for example –

- the recipient must retain the relevant supporting documentation prescribed under section 20(8)<sup>11</sup> in order to deduct input tax (commonly referred to as “notional input tax”);
- the deduction is limited to the extent that a monetary payment is made for the supply;
- the input tax deduction is further limited to the open market value of the second-hand goods; and
- the second-hand goods constitutes **fixed property**<sup>12</sup> –
  - **acquired before 10 January 2012** – the input tax could be deducted to the extent that payment for the property is made and after the transfer duty had actually been paid or any applicable exemption from transfer duty had been

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<sup>10</sup> See the Binding General Ruling on documentary proof in relation to the deduction of input tax on importation for more clarity in this regard (At the time of issue of this Guide this publication was still in draft).

<sup>11</sup> This includes obtaining a completed declaration by the supplier (form VAT 264) or any documentation containing such information as is acceptable to the Commissioner as well as proof of payment.

<sup>12</sup> In the case of municipalities registered on the payments basis.



granted. As municipalities are exempt from transfer duty, the deduction would have been limited to the transfer duty that would have been payable had the exemption not applied;

- **acquired on or after 10 January 2012** – the input tax may only be deducted to the extent that payment for the property is made, provided the time of supply rule under the VAT Act has occurred. The time of supply is the earlier of the date that any consideration was paid, or that the transfer of the property is made into the transferee's name in the relevant deeds registry.

Apart from input tax, there are other specified deductions which a vendor is allowed to make in the calculation of its VAT liability or refund for a tax period.<sup>13</sup> You need to be in possession of documentary proof which is prescribed by the Commissioner to substantiate such specified deductions as set out in Binding General Ruling on the Documentary proof prescribed by the Commissioner.<sup>14</sup>

Section 16(2)(g) was introduced with effect from 1 April 2016 to provide relief to vendors who, under certain circumstances prescribed by the Commissioner, are **unable** to obtain the documentation prescribed under section 16(2)(a) to (f) in order to substantiate an input tax and/or other deduction. Under such circumstances, a vendor may be permitted to make a deduction, provided that vendor is in possession of alternative documentary proof containing certain minimum information acceptable to the Commissioner. In such cases, the vendor is required to apply for permission in the form of a ruling from SARS before making the deduction in any return. The requirements for accessing the relief under section 16(2)(g) are set out in a draft binding general ruling published on the **SARS website**.

## 5.2 Direct attribution vs. apportionment

In establishing the amount of input tax that may be deducted, the principle of direct attribution is used. Therefore, where goods or services are acquired –

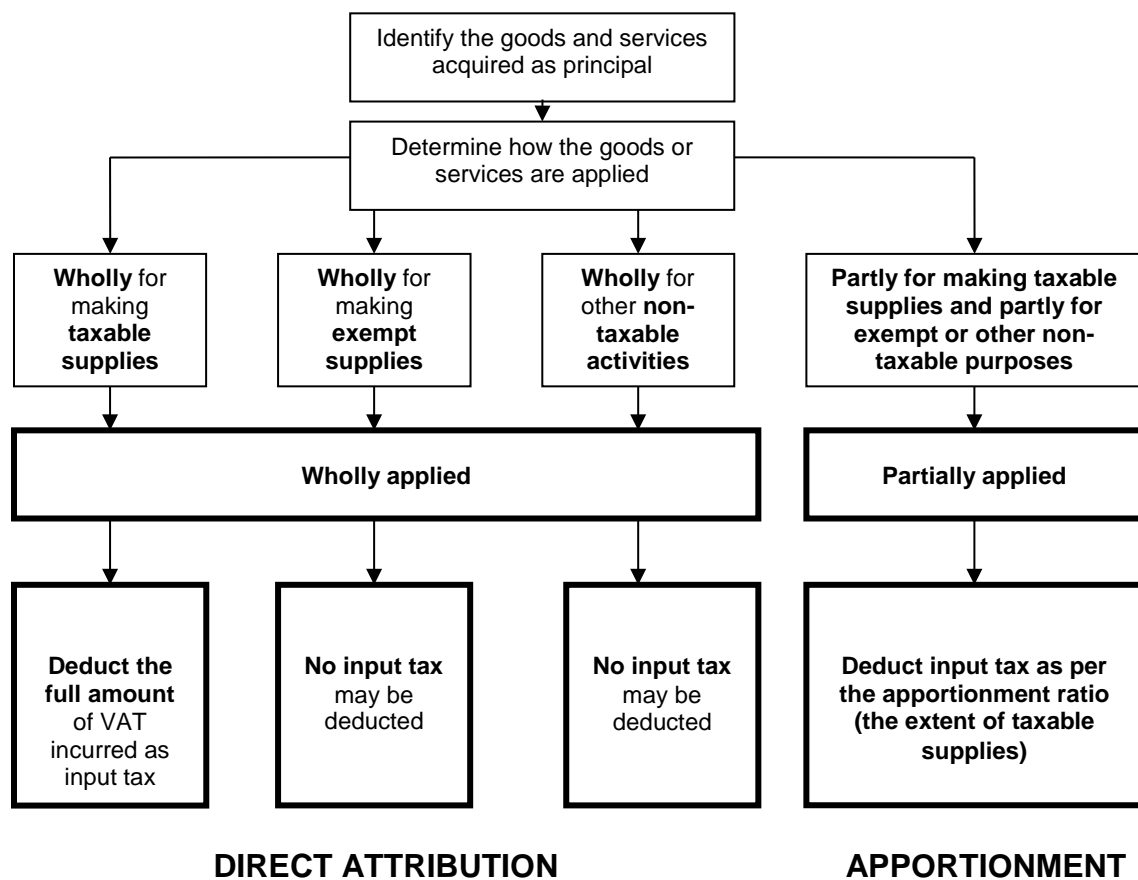
- wholly for making taxable supplies, the full amount of VAT incurred is deducted as input tax;
- wholly for making exempt supplies or other non-taxable purposes, no input tax can be deducted because the VAT is directly attributable to the municipality's non-enterprise activities; and
- for making both taxable and exempt supplies or other non-taxable purposes (commonly referred to as "mixed supplies"), only a fair and reasonable proportion of the VAT incurred may be deducted as input tax.

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<sup>13</sup> Refers to deductions set out in section 16(3)(c) to (n).

<sup>14</sup> At the time of issue of this Guide this publication was still in draft

The diagram below illustrates the concepts of direct attribution and apportionment:



### 5.2.1 Direct attribution

As shown above, where the acquisition of goods or services can be identified as being exclusively or wholly for a particular purpose, the VAT incurred on those supplies can either be deducted in full (wholly for taxable supplies), or input tax may be not be deducted at all (exempt or other non-taxable purposes). In applying the concept of direct attribution the manner in which expenses are incurred, and the actual application of the goods or services in the business, must be examined.

In a case where a vendor makes only taxable supplies, this is a simple exercise in that the VAT incurred will usually be exclusively for taxable supplies, and the input tax can be deducted in full. However, in most cases, a municipality will make taxable, exempt and out-of-scope supplies. This means that when a municipality incurs an expense, it must first establish if the expense is directly attributable to exempt or other non-taxable supplies or to taxable supplies before applying an apportionment ratio to deduct input tax.

The apportionment of input tax is only applicable to expenses that cannot be directly attributed as explained above. In other words, apportionment only applies where the expense is incurred for mixed-use purposes (that is, taxable and non-taxable purposes).

The process of applying direct attribution can be facilitated by the way in which a municipality organises its different activities into divisions or business units. For example, where the individual divisions or business units have control over their own budgets and expenditure decisions, and if they are structured to exclusively account for taxable or exempt activities in each division, it is much easier to apply direct attribution. It is envisaged that once the *mSCOA*

system is introduced, it will be possible, through the design of the accounts, to carry out the process of direct attribution or allocation more accurately.

This concept is illustrated in **Examples 12 to 14** below:

#### **Example 12 – Direct attribution: Taxable supplies**

*Facts:*

ABC Municipality buys a truck costing R342 000 (including VAT) for the removal of garbage from the properties of all owners residing within its demarcated area. The removal of garbage qualifies as an “enterprise” activity, which is a taxable activity.

*Result:*

As the truck was acquired exclusively for making taxable supplies, the expense is wholly attributable to making taxable supplies and ABC municipality can therefore deduct the full amount of VAT charged as input tax ( $R342\,000 \times 14 / 114 = R42\,000$ ).

#### **Example 13 – Direct attribution: Exempt supplies**

*Facts:*

ABC Municipality runs a fleet of buses which is used exclusively to provide local public passenger transport. The municipality imports a new bus for the purposes of its passenger transport business and pays an amount of R32 000 VAT on the value of the bus on importation.

*Result:*

As local transportation of fare-paying passengers in a bus is exempt from VAT under section 12(g), the VAT paid is wholly attributable to making exempt supplies. ABC Municipality therefore cannot deduct any VAT as input tax in respect of the VAT paid on the importation of the bus.

#### **Example 14 – Direct attribution vs. apportionment**

*Facts:*

On 1 November 2015, ABC Municipality rents a two-storey building under a single lease agreement which houses its public passenger transport and municipal rates divisions. The divisions occupy the ground floor and first floor of the building respectively. The divisions utilise the same software which has been implemented across all of ABC Municipality’s different divisions and it receives a single telephone account each month for telephone usage from the building address.

The municipality does not maintain separate cost centres for each division.

Furthermore –

- the lease agreement does not provide for separate rental amounts for each division;
- the cost of the computer software relates to the organisation as a whole; and
- the account for the use of telephones is not billed to each division separately.

**Result:**

The public passenger transport division makes only exempt supplies and the municipal rates division makes only taxable supplies. Although the divisions are organised along the lines of wholly taxable and wholly non-taxable activities, ABC Municipality has not arranged its contracts or implemented accounting methods to specifically allocate costs incurred by each division.

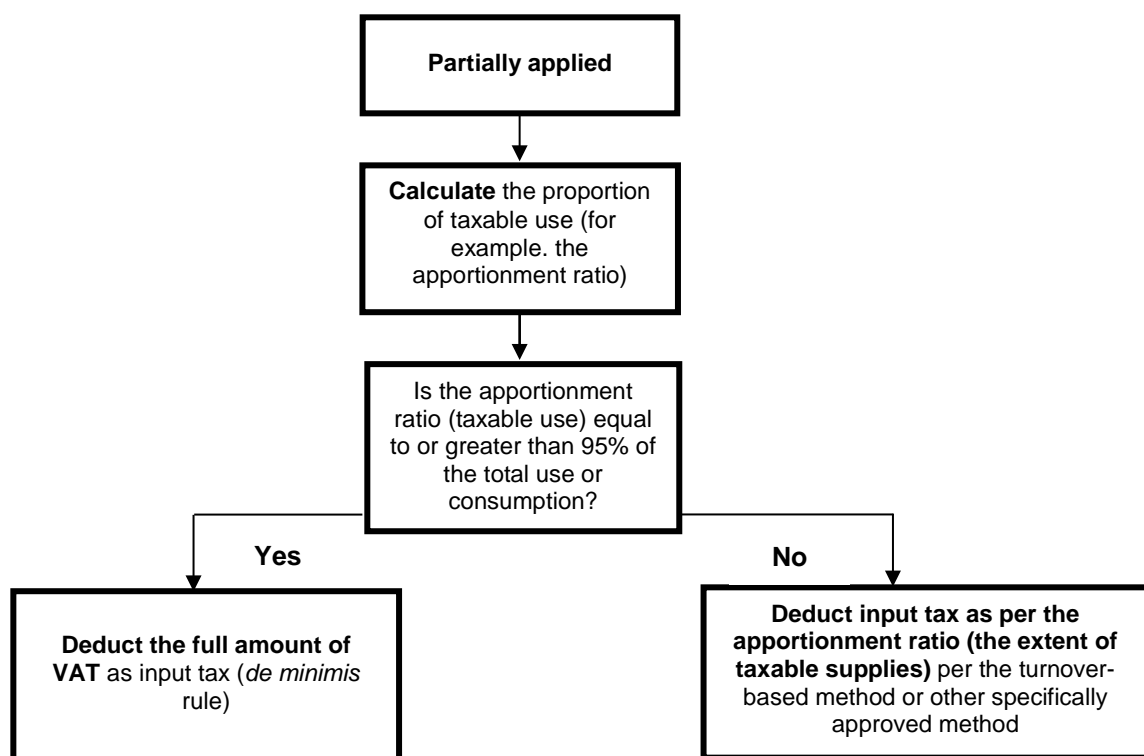
ABC Municipality is unable to attribute its expenses wholly to taxable or wholly to exempt supplies.

It follows that ABC Municipality would have to apportion the VAT incurred in relation to these expenses as set out in the chapter below.

**5.2.2 Apportionment methodology**

Once it has been established that the expense cannot be directly attributed wholly to taxable and exempt or other non-taxable purposes, the second level of enquiry is to determine the portion of the VAT that may be deducted as input tax, based on the extent to which the intended use is for taxable purposes.

Following on from the diagram under 5.2, the second level of enquiry in establishing the apportionment percentage is illustrated in the diagram on the following page:

**Establishing the apportionment percentage**

The intended use for taxable purposes (apportionment ratio) is determined by using a formula or method approved by the Commissioner so that only a fair and reasonable proportion of the VAT incurred may be deducted as input tax.<sup>15</sup>

<sup>15</sup> See section 17(1) as amended.

Binding General Ruling (BGR) 4 prescribes the specific turnover-based apportionment method to be applied by all municipalities when calculating the amount of VAT incurred that may be deducted in respect of goods or services acquired for mixed purposes. BGR 4 provides guidance as to specific items that must be included in, or excluded from, the formula.

In a case where a municipality is given a specific ruling to apply an apportionment method other than BGR 4, that vendor cannot go back to using the previous method, where it is inappropriate, without requesting a further ruling.

For more details on the prescribed method of apportionment for municipalities, see **Annexure C**.

#### **Example 15 – Application of the *de minimis* rule**

On 1 July 2014, ABC Municipality buys computer software for R456 000 (including VAT). The apportionment ratio as prescribed by BGR 4 is determined to be 96% (intended extent of taxable use) based on the turnover-based method of apportionment. The software is used to administer the supplies of all the taxable and exempt divisions of the municipality. The software is therefore used by ABC Municipality partly in the course of making taxable supplies and partly for making exempt supplies. However, since the apportionment ratio is calculated as being 96%, the full amount of VAT may be deducted as input tax. This is because the *de minimis* rule (where the ratio is 95% or more) may be applied so that the entire expense is regarded as being in respect of making taxable supplies. As a result, the full amount of R56 000 VAT incurred on the acquisition of the computer software may be deducted as input tax.

Calculation:

$$[R456\,000 \times 14 / 114] \times 100\%$$

$$=R56\,000$$

For more information on input tax and apportionment, including year-end adjustments which may be required, see 8.4 of the *VAT 404 – Guide for Vendors*.

### **5.3 Accounting basis**

Municipalities are permitted to account for VAT on the payments basis. Where a municipality applies the payments basis method of accounting, input tax may only be deducted to the extent that –

- payment for the taxable supply of goods or services acquired has been made by the municipality; and
- the VAT was incurred for the purpose of consumption, use or supply in the course of making taxable supplies.

Any vendor, other than a municipality or public entity, which generally accounts for VAT on the payments basis, must account for VAT on the invoice basis in relation to transactions where the consideration for the supply exceeds R100 000.

See **5.3** for more details, as well as Chapter 4 of the *VAT 404 – Guide for Vendors*.

## 5.4 Denial of input tax

### 5.4.1 Entertainment

The general rule regarding entertainment is that when a vendor incurs expenses relating to entertainment, the VAT included in that expense may not be deducted as input tax. There are, however, some exceptions to this rule. For example, a vendor that continuously and regularly supplies entertainment to clients or customers will be entitled to deduct input tax where it supplies entertainment for a charge that covers all the direct and indirect costs of making the supply, or such charge is equal to the open market value of the supply of such entertainment.

Another exception which applies specifically to municipalities and not to other vendors is that a municipality is allowed to deduct input tax where it incurs entertainment expenditure for the purpose of providing sporting or recreational facilities or public amenities to the general public. [See proviso (v) to section 17(2)(a)].

A municipality will therefore be able to deduct input tax in relation to the creation or maintenance of those recreational facilities. However, where entertainment goods or services are acquired for the purpose of hosting an event at sporting or recreational facilities or public amenities, the deduction of input tax must be considered against the provision of section 17(2)(a)(i)

See the *VAT 404 – Guide for Vendors* for more information in this regard.

#### **Example 16 – Denial of input tax (entertainment – staff refreshments)**

*Facts:*

ABC Municipality acquires tea and coffee to supply to its staff free of charge.

*Result:*

As the provision of tea and coffee falls within the ambit of “entertainment” as defined in section 1(1) and as the municipality does not supply the entertainment for a charge which covers all the direct and indirect costs of providing the entertainment nor equals the open market value thereof, it will not be entitled to deduct any input tax.

#### **Example 17 – Exception to the denial of input tax (entertainment – public recreation facilities)**

*Facts:*

ABC Municipality incurs expenses (including VAT) to develop a public park that includes amenities, such as swings, slides and other playground facilities, including a sports field, for the entertainment of children. The facilities are made available free of charge to the general public.

*Result:*

Proviso (v) to section 17(2)(a)(i) allows the municipality to deduct input tax on the entertainment expenses which were incurred to provide the playground and sports facilities, even though it does not supply the entertainment for a charge which covers all the direct and indirect costs of providing that entertainment.

### 5.4.2 Motor cars

As a general rule, vendors are not entitled to deduct input tax on the acquisition of a “motor car” as defined in section 1(1). This rule applies equally to municipalities. The deduction of input tax is prohibited even in instances when the motor car is acquired by the municipality wholly for purposes of making taxable supplies.

The subsequent sale of the motor car by the municipality will not be subject to VAT.<sup>16</sup> A municipality may however deduct the VAT incurred on the running and modification costs to the extent that the motor car is used in the course or furtherance of its enterprise. Running costs include the repair, maintenance and insurance expenses of the motor car, while the modification expenses for example, the installation of a canopy or roof rack.

The disallowance of an input tax deduction on the acquisition of a motor car does not apply to foreign donor funded projects. If a municipality is separately registered in respect of a foreign donor funded project, it will be allowed to deduct input tax on the acquisition of a motor car applied in the course or furtherance of that foreign donor funded project.

See Interpretation Note 82 Input tax on motor cars for further information.

#### **Example 18 – Denial of input tax (motor cars)**

*Facts:*

ABC Municipality acquires a motor car for use by its electricity division. The motor car is used by that division wholly for purposes of travelling to the premises of various customers in order to take meter readings.

*Result:*

The VAT incurred on the acquisition of the motor car is specifically denied. The VAT expense may not be deducted as input tax by ABC Municipality even though the motor car will be used wholly for taxable purposes. If the motor car is subsequently sold by ABC Municipality, it will not charge VAT on the supply [section 8(14)].

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<sup>16</sup> Section 8(14).

## Chapter 6 Adjustments

### 6.1 Introduction

Certain adjustments to output tax or input tax may arise for a vendor who is registered on the invoice basis of accounting. For example where –

- an irrecoverable debt is written off;
- early payment of an account gives rise to a settlement discount;
- a debit or credit note is issued or received; a customer returns faulty goods to the municipality;
- a change in use from wholly or partially taxable consumption, use or application to wholly non-taxable use occurs;
- a change in the extent of taxable consumption, use or application of capital goods or services occurs; and
- an adjustment in respect of the apportionment percentage is required to correct past deductions of input tax.

Most municipalities account for VAT on the payments basis and as such should generally not be required to make any adjustments to output tax or input tax in circumstances contemplated in the first two bullet points above.

Adjustments are discussed in detail in Chapter 15 of the *VAT 404 – Guide for Vendors*, including adjustments which may, or may not be applicable to municipalities. For the purpose of this chapter, only the adjustments which involve a change in consumption, use or application of goods or services after being acquired by a municipality are discussed.

### 6.2 Change in use from wholly or partially taxable purpose to wholly non-taxable purpose

There are two main aspects to consider with regard to a situation where a municipality applies goods or services for a wholly non-taxable purpose after it was originally acquired wholly or partly for making taxable supplies. The first aspect is that where this situation occurs, the municipality is regarded as having made a supply of those goods or services and will have to declare output tax on the open market value of the supply.

The second aspect is that where those goods or services were originally applied only partly for taxable supplies, the municipality would have been able to deduct only a portion of the VAT as input tax. Therefore, when the goods or services are applied wholly for non-taxable purposes, a “claw-back” input tax credit [section 16(3)(h)] applies so that input tax is allowed on that portion which could not previously be deducted. This “claw-back” provision does not, however, apply in respect of goods or services which were originally acquired and used partly for out-of-scope supplies before 1 July 2006.<sup>17</sup>

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<sup>17</sup> The out-of-scope supplies referred to here are those that did not qualify as taxable supplies because they were not listed as taxable business activities in Regulation 2570. Regulation 2570 was withdrawn with effect from 1 July 2006.



Similarly, where a municipality sells or otherwise disposes of any goods or services which were acquired and applied in the course of making both taxable and out-of-scope supplies before 1 July 2006, output tax will be payable on the full consideration charged, but no “claw-back” input tax credit will be allowed. [See proviso (iii) to section 16(3)(h)].

### **Example 19 – Change in use from wholly taxable to wholly non-taxable purposes**

#### *Facts:*

ABC Municipality acquired a bus on 1 October 2013 and used the bus wholly for taxable supplies by hiring the bus out (without a driver) to schools and other customers on a regular basis. On 1 November 2015 the municipality decided to use the bus exclusively in its passenger transport division to provide public transport.

#### *Result:*

ABC Municipality can deduct the VAT incurred on the bus in the October 2013 tax period as it was initially acquired wholly to make taxable supplies. However, from 1 November 2015 the bus was applied wholly for making exempt supplies. ABC Municipality must therefore make an output tax adjustment based on the open market value of the bus in the November 2015 tax period [section 18(1)].

If ABC Municipality had acquired the bus before 1 July 2006 for purposes of hiring it out, that activity would have been non-taxable (out-of-scope) and no input tax would have been allowed as a deduction at the time of the original acquisition. When the law changed so that the activity became taxable on 1 July 2006, ABC Municipality would not have been able to make an input tax adjustment on the application of the bus for making taxable supplies [proviso (v) to section 18(4)], even though output tax must be declared on the change in use on 1 November 2015. The reason is that the purpose of proviso (v) to section 18(4) is to specifically deny an input tax adjustment on any assets held by a municipality when the law changed with effect from 1 July 2006.

## **6.3 Change in use from non-taxable purposes to taxable purposes**

A vendor may deduct input tax where goods or services held for exempt or other non-taxable purposes if those things are subsequently applied for consumption, use or supply in the course of making taxable supplies. The deduction will not, however, apply if a deduction of input tax is specifically denied on the goods or services concerned (for example, a motor car or goods acquired for entertainment purposes). The full adjustment must be made in the tax period in which the goods or services are applied for taxable purposes, whether the vendor accounts for VAT on the invoice or payments basis.

The adjustment is calculated by applying the tax fraction (14/114) to the lesser of the adjusted cost or the open market value of the goods or services (including VAT). However, the deduction of input tax is not be allowed where the goods or services were originally acquired and applied for “out-of-scope” supplies before 1 July 2006.

**Example 20 – Change in use from non-taxable to taxable use or application***Facts:*

Municipality Q, purchased a single-cab bakkie on 1 March 2006 for exclusive use in the passenger transport division in connection with the maintenance of buses used for transporting fare-paying passengers (wholly exempt supplies). The bakkie cost R228 000 (including VAT). On 1 April 2015, Municipality Q decided to use the bakkie exclusively in the township development division for purposes of transporting building equipment to the various building sites (wholly for taxable supplies). At the time of the change in use the bakkie had an open market value of R57 000.

*Result:*

As the bakkie was originally acquired for exempt purposes, no input tax would have been allowed on the original acquisition. However, Municipality Q would be entitled to an input tax deduction of R7 000 ( $R57\ 000 \times 14 / 114$ ) in the April 2015 tax period on the change of use to taxable purposes the bakkie was applied for taxable purposes after 1 July 2006.

In this case, the denial of an input tax deduction under proviso (v) to section 18(4) as discussed in of **Example 18** does not apply because the bakkie was not used for making supplies that were out-of-scope before 1 July 2006.

**6.4 Change in extent of taxable use of capital goods or services**

The general rule is that where a vendor increases or decreases the extent of use of capital goods or services to make taxable supplies, an adjustment must be made to output tax or input tax, as the case may be [sections 18(2) and 18(5)]. An adjustment to output tax will be required where there is a *decrease* of more than 10% in the extent of taxable use or application by the vendor of capital goods and services which have an adjusted cost of R40 000 or more when compared to the previous financial year. Similarly, an adjustment to input tax may be permitted where there is an *increase* of more than 10% in the extent of taxable use or application by the vendor when compared to the previous financial year of capital goods and services which have an adjusted cost of R40 000 or more.

These rules also apply to municipalities and they are aimed at ensuring that where capital goods and services are used for mixed use purposes, the input tax which may be deducted must be in proportion to the extent to which those assets are applied for taxable use in the municipality's "*enterprise*" over the lifetime of the assets. However, these adjustments (input tax and output tax) will not apply in the case of a municipality that acquired the capital goods or services before 1 July 2006 for making "out-of-scope" supplies, and applied them as such.

The "out-of-scope" supplies referred to here are all the supplies which before 1 July 2006 would not have qualified as taxable supplies because they were not listed as taxable business activities in *Regulation 2570*. The effect of this provision is therefore to treat the capital goods or services which were acquired before 1 July 2006 and used partly for taxable supplies after 1 July 2006 in such a way that the annual variation in the extent of taxable use will not create an output tax or input tax adjustment event. An output tax liability will only arise when the asset is eventually sold, donated, exchanged or where there is a change in use to a wholly exempt purpose [section 18(1)].

**Example 21 – Capital goods or services: Increase/decrease in the extent of taxable use or application***Facts:*

On 1 December 2014, ABC Municipality bought a computer system for R456 000 (including VAT). ABC Municipality's apportionment ratio is determined to be 90% (that is, the intended use for taxable purposes) based on the turnover-based apportionment method prescribed in BGR 4. The computer system is used to administer the supplies of all the taxable and exempt divisions of the municipality. On 30 June 2015 ABC Municipality determined its apportionment ratio to be 75% and the open market value of the computer system on that date is R342 000.

*Result:*

The computer system is used by ABC Municipality partly in the course of making taxable supplies and partly for making exempt supplies. Therefore, an amount of R50 400 [(R456 000 × 14 / 114) × 90%] may be deducted as input tax in the December 2014 tax period. As there is a subsequent change in the extent of taxable use of more than 10% of the capital asset (decrease), ABC Municipality will be required to make an output tax adjustment, in the June 2015 tax period, calculated as follows:

$$\begin{aligned}\text{Output tax adjustment} &= 14 / 114 \times R342\,000 \times (90\% - 75\%) \\ &= R42\,000 \times 15\% \\ &= \mathbf{R6\,300}\end{aligned}$$

**Notes:**

1. Had the apportionment percentages for the respective financial years been reversed (that is, 75% in the first year which increased to 90% in the second year), the same calculation would be used to calculate the input tax adjustment on the increase in the extent of use for taxable purposes.
2. If the computer system was bought before 1 July 2006 the adjustment will not be required, whether it is in respect of an increase or a decrease in the extent of application for taxable supplies.

## Chapter 7

### Miscellaneous matters

#### 7.1 Introduction

Specific issues which are not discussed in detail in other chapters are highlighted in **7.2** to **7.9** below to provide clarity.

#### 7.2 Metro Police

Police and law enforcement services such as those provided by the South African Police Service (SAPS) are not specifically exempt under section 12. However, as the SAPS is a public authority and may not register for VAT, the same effect of an exemption on the provision of those services is achieved. Similarly, metropolitan police and traffic control services provided by municipalities are also not exempt under section 12. The difference is that a municipality will normally be registered for VAT and these activities are included in paragraph (a) of the definition of “enterprise”.

under section 156(1)(a) of the Constitution, a municipality administers municipal roads as well as traffic and parking, which are local government activities listed in Part B of Schedule 4 and Part B of Schedule 5 to the Constitution. It follows that the activities performed by a municipality in connection with metropolitan police and traffic control matters are, by default, taxable “*enterprise*” activities.

Even though the metro police division of a municipality might not necessarily charge a specific consideration for most of its services, the activities are still regarded as being a part of the municipality’s “*enterprise*” as a whole. Therefore, any consideration charged in respect of such services will be subject to VAT at the standard rate, unless a different result is expressly provided for in the VAT Act, for example –

- zero-rated under section 11 (for example a “*grant*”);
- exempt under section 12 (for example, fare-paying passenger transport services); or
- “out-of-scope” or non-supplies (for example, statutory fines and penalties).

Consequently, any income from parking meters which is a charge for street parking, or, for example charges for escorting abnormal vehicles through a city must be declared as standard rated supplies and output tax must be paid thereon. Similarly, where the metro police division of a municipality sells or otherwise disposes of any goods or services that were acquired and applied in the course of making out-of-scope supplies before 1 July 2006, output tax is payable on the full consideration charged. No input tax deduction or adjustment is allowed in respect of these supplies as they were not listed as taxable business activities in Regulation 2570. (See **6.2** and the footnote relating to that paragraph.). For example, if the metro police division acquires new office furniture, it may deduct input tax to the extent that the furniture is used to make taxable supplies, but the sale of the old furniture acquired before 1 July 2006 attracts VAT at the standard rate, and no input tax deduction (adjustment) is allowed thereon.

Income from statutory fines for speeding and other traffic violations does not attract VAT, since those amounts are not in respect of any supply of goods or services by the municipality. A municipality is only entitled to deduct input tax in respect of the VAT incurred on goods or services acquired which relate to the taxable enterprise activities of the metro police division of a municipality. It follows that any VAT incurred which is directly attributable to non-enterprise activities may not be deducted as input tax. For example, the VAT incurred

on the rental or purchase of cameras used for the imposition of speeding fines is directly attributable to non-supplies (speeding fines) and may not be deducted as input tax. In addition, any VAT incurred on expenses for a mixed purpose may be deducted to the extent allowed for the municipality as a whole as determined in BGR 4.

Input tax specifically denied as discussed in 5.4 cannot be deducted.

### 7.3 Assignment of functions, agency services and unfunded mandates

National and provincial governments are mandated to perform certain activities in the functional areas listed in Part A of Schedule 4 and Part A of Schedule 5 to the Constitution. Municipalities have the right to administer the local government activities listed in Part B of Schedule 4 and Part B of Schedule 5 to the Constitution (see **Annexure B**). National and provincial governments may also assign certain of the activities mandated to them to a municipality (by agreement and subject to any conditions), if the matter would be most effectively administered locally, and if the municipality has the capacity to administer it. As a result, activities usually forming part of the mandate of provincial government sometimes end up being formally assigned to a municipality. This essentially means that the municipality will carry all the rights and obligations in relation to carrying on the assigned activity. This will normally include the right to receive any grant from government which would, in the absence of such assignment, have been paid to the province to carry out the activity. The result for VAT purposes is that the activity will form part of the municipality's enterprise unless the activity itself is exempt.

Alternatively, the provincial government may appoint a municipality as its agent to carry on certain activities that will assist in carrying out its mandate. For example, municipalities are often involved in the collection of motor vehicle licence and registration fees on behalf of provinces. The VAT effects of these two scenarios (that is, being agent or principal) are vastly different and will be discussed further below. See also **Chapter 3**.

In addition, there are situations in which a municipality may have no involvement in the province's activity, or where it merely acts as agent of the province, but it is nevertheless expected to contribute financially to assist the provincial government to carry out its mandate. Municipalities refer to these activities as "unfunded mandates" because, in terms of the Constitution, they are expected to contribute financially to the provision of goods or services, when these activities are actually the mandate of the provincial government. In a sense, these are activities where both provincial governments and municipalities have a shared constitutional responsibility to deliver goods or services to the general public. Examples of these "unfunded mandate" activities include the provision of PHC services in provincial hospitals and municipal clinics and the activities associated with the administration and maintenance of certain museums and libraries.

In establishing which scenario is applicable in any particular case, the SLA between the municipality and provincial government should be examined. Sometimes the SLA may not be so clear and in other cases there may not even be an SLA in writing to examine. However difficult it may be to determine the contractual relationship, this is something which is essential to establish, as the VAT treatment of the supplies between the parties will follow accordingly.

Ideally, the SLA should clearly indicate the relationship between the parties and the nature of the supplies concerned. Alternatively, in the absence of a written SLA, the parties should at least have a clear understanding (and agreement) of the contractual rights and obligations

which are created by the arrangement in terms of which the underlying activity is conducted by the parties.

Three main situations may arise as set out below:

- **Activities assigned by provincial government to a municipality**

*Output tax* – In this case, the municipality is regarded as the principal in respect of the assigned activity and it forms an integral part of the municipality's "enterprise" activities as a whole. Therefore, when the municipality makes supplies of goods or services in regard to activities which have been assigned to it, these constitute taxable supplies and output tax must be accounted for by the municipality, where there is a consideration charged. The municipality is deemed to supply a zero-rated service to the provincial government to the extent that it provides the municipality with financial assistance (a "grant") to enable it to carry on the assigned activities. As such, the payment will not be regarded as standard rated consideration for actual services provided by the municipality to the provincial government.

*Input tax* – The normal rules for the deduction of input tax will apply, as the municipality (as principal) is entitled to deduct input tax in respect of the VAT incurred on goods or services acquired which relate to the taxable "enterprise" activities of the municipality.

- **The provincial government appoints a municipality as agent**

*Output tax* – In this case, the activity remains that of the provincial government. The municipality merely acts as the legal agent of the province in assisting it to fulfil its mandate. If the municipality charges the provincial government an agency fee, or other amount for goods or services supplied, the amount constitutes consideration for a taxable supply by the municipality at the standard rate. In some cases the agency fee or other charge is determined with reference to another amount – for example, a certain percentage of salaries. It is not the manner of calculating the fee which is important, but rather whether the final amount payable to the municipality is in respect of a taxable supply (for example, agency services, rental etc). Furthermore, where the underlying provincially mandated activity (for example, PHC services) has not been assigned to a municipality, any payment by the province to the municipality for goods or services supplied cannot qualify as a zero-rated "grant".

*Input tax* – The normal rules apply in that the municipality is entitled to deduct input tax in respect of VAT incurred on goods or services acquired which relate to the provision of taxable agency services, or other taxable supplies made by the municipality, as the case may be.

- **The municipality has an "unfunded mandate"**

Municipalities are allowed to deduct input tax where they make a financial contribution by acquiring goods or services in connection with the carrying out of activities falling within the mandate of provincial government, for example, PHC services, or the provision of museum or library facilities.

Any VAT incurred and paid for directly by the municipality in respect of these provincial mandates is regarded as being incurred by the municipality in the course or furtherance of the municipality's own "enterprise" (unless the activity itself is exempt, for example, the supply of educational services). The input tax deducted must be supported by tax invoices issued to the municipality, for example, medicines purchased to supply PHC services, insurance cover in respect of medical staff involved in supplying PHC services, purchase of library books, maintenance costs of museum buildings etc.

The following examples illustrate the points made above with reference to the VAT treatment of PHC services which are the mandate of the provincial government in the first instance, but where a municipality may have some role in making the supplies. For example, where it acts as agent or has been assigned the activity, or where it has to make a financial contribution towards making the supplies.

### **Example 22 – PHC services assigned to a municipality**

*Facts:*

Province Y assigns the activity of providing PHC services within Municipality X's and Municipality Z's demarcated areas to Municipality X. Municipality X charges a standard amount of R100 per patient and must carry out the functions as set out in the SLA.

*Result:*

As the activity has been assigned to Municipality X as provided in the Constitution, it is regarded as the principal for the purposes of the PHC services supplied in terms of the SLA. Therefore, all expenses incurred in carrying on the activity are for Municipality X's account and it may deduct input tax thereon under the normal rules for the deduction of input tax. Similarly, VAT must be charged at the standard rate on the R100 charged to patients as PHC services do not constitute exempt supplies (section 12), nor are they subject to the zero rate (section 11). Where Province Y provides Municipality X with a subsidy to enable it to carry on the activity of providing PHC services (taxable supplies), the receipt constitutes a "grant" and the deemed supply which arises in respect thereof is subject to VAT at the zero rate in the hands of Municipality X.

### **Example 23 – Municipality acts as agent and has an unfunded mandate**

*Facts:*

Province Y provides PHC services within Municipality X's demarcated area and charges R100 per patient. Municipality X acts as the agent of Province Y in overseeing and managing the activity on behalf of Province Y under an SLA. Municipality X charges an agency fee of R50 per patient per month (including VAT). In addition Municipality X purchases medicines and pays R20 000 (inclusive of VAT) to the supplier as its financial contribution towards Province Y's activities ("unfunded mandate").

*Result:*

The agency fee charged by Municipality X to Province Y is in respect of a taxable supply of agency/management services and is subject to VAT at the standard rate. The VAT charged by Municipality X is therefore a cost to Province Y as it is not a vendor. The SLA between Municipality X and Province Y should state that this fee is inclusive of VAT at the standard rate, but where the agreement is silent on this aspect, the fee is deemed to be inclusive of VAT at the standard rate<sup>18</sup>. The medicines are regarded as being acquired in the course or furtherance of Municipality X's own enterprise, as this financial contribution is part of their "unfunded mandate". Consequently, Municipality X may deduct input tax of R2 456.14 (R20 000 × 14 / 114) provided that the supplier makes the supply of the medicines to Municipality X and provides the required tax invoice in the name of Municipality X.

<sup>18</sup> Section 64.

## 7.4 Payments to suppliers on behalf of grantees

In 4.5.1, it was stated that where the grantor pays a supplier of goods or services directly on behalf of the grantee (municipality), this does not mean that the supplier may charge the zero rate on the supply made to the grantee.

Public authorities should therefore take note of the direct effect of making such payments which has the following effect:

- The grantee (municipality) is still deemed to make a zero-rated deemed supply to the grantor in respect of the payment.
- The supplier must still charge VAT on the actual supply at the standard rate (if it is a taxable supply).
- The supplier must still issue a tax invoice to the recipient (being the municipality).

Following on from the direct effects mentioned above, further effects which need to be considered, are as follows:

- The supplier might be under the impression that the supply is made to the public authority and issue the tax invoice to the public authority instead of the municipality which means that the municipality would not be able to deduct input tax.
- The municipality may omit to include the receipt in its records, which, in turn, will mean that its taxable supplies (zero-rated) may be understated.
- The municipality may receive an unintended additional subsidy where the VAT element was included in the payment to the supplier and where the municipality deducts the VAT charged as input tax when it receives the tax invoice from the supplier (sometimes referred to as “double-dipping”).
- Where the grantor did not intend to allow the municipality to “double-dip”, but merely to cover the VAT-exclusive “cost” of a supply, the grantor might request for the VAT which was deducted as input tax to be repaid. In the case of such a refund to the grantor, there may be VAT implications. For example, the value of taxable supplies in the apportionment formula will need to be adjusted. In this instance the value of taxable supplies (reflected in the numerator) must be reduced by the full value of the amount refunded. Alternatively, the adjustment must be made by reducing the value of exempt or non-supplies (in the denominator) to the extent that the amount was included in those values.

### **Example 24 – Effect of payments made to third parties on behalf of municipalities**

#### *Facts:*

Public Authority X has budgeted for a grant of R5 000 000 to be made to Municipality Y to cover the “cost” of installing water pipes and other infrastructure in a township in its demarcated area. Municipality Y engages a private contractor, who is a registered vendor, who quoted R5 700 000 (including R700 000 VAT) to carry out the work (therefore a “cost” of R5 000 000 to Municipality Y).



The infrastructure will be owned by Municipality Y and is for the purposes of supplying water to Municipality Y's customers (taxable supplies). However, as the contractor has complained that Municipality Y is six months in arrears with its progress payments, Public Authority X decided to pay the progress payment of R3 420 000 (including R420 000 VAT) directly to the contractor. Six months later, the contractor approaches Public Authority X again for payment of the balance of the progress payments in respect of the contract price of R2 280 000 (including R280 000 VAT).

*Result:*

Municipality Y must report the full grant payment of R3 420 000 as being a receipt in respect of a deemed taxable supply at the zero rate and the contractor must issue a tax invoice in the name of Municipality Y for a VAT-inclusive amount of R3 420 000. Upon receipt of the tax invoice, Municipality Y will deduct input tax of R420 000 ( $R3\,420\,000 \times 14 / 114$ ). Note at this point, Municipality Y has deducted R420 000 as input tax, so its infrastructure "cost" so far is R3 000 000, whereas Public Authority X has outlaid R3 420 000.

As it is clear in this example that Public Authority X only intended the grant to cover the VAT-exclusive "cost" of the installation (R5 000 000), it is only required to pay the balance of R1 580 000 (being R5 000 000 minus R3 420 000) six months later being the balance of the "cost".

This however creates a problem in that –

- the contractor seeks payment of the full balance of the contract price of R2 280 000 (including VAT); and
- if Public Authority X paid the full amount of R2 280 000 (including VAT) again to the contractor it would have in fact paid R5 700 000 in total to the contractor on behalf of Municipality Y.

The amount paid on behalf of Municipality Y would be in excess of the intended grant if Public Authority X has not taken into account the fact that Municipality Y can deduct input tax of R700 000 ( $R5\,700\,000 \times 14 / 114$ ) on the full contract price.

Similarly, if the full VAT-inclusive amount of R5 700 000 was paid to Municipality Y without requiring the VAT component of R700 000 to be refunded at a later stage, it would have paid a grant amount of R700 000 more than it had intended.

However, if Public Authority X had only paid the "cost" amount to the supplier, or to Municipality Y, Municipality Y would have to outlay the VAT charge temporarily from its own cash resources before deducting it as input tax.

This example demonstrates once again how important it is to carry out the costing and budgeting exercise properly for projects of this nature.

## 7.5 Municipal entities

A municipal entity is not a “*municipality*”. Municipalities create municipal entities for the purpose of conducting certain activities with the aim of achieving better service delivery to the community.

In terms of the Municipal Systems Act, a municipality may establish the following (municipal) entities:

- A private company in which a municipality, or two or more municipalities collectively, have effective control.
- A service utility which is a juristic person under the sole control of the municipality which established it.
- A multi-jurisdictional service utility which is a juristic person under the shared control of the parent municipalities (the two or more municipalities who established the service utility by written agreement).

It follows that:

- A municipal entity is a separate juristic person to the municipality that created the entity and will have to register separately for VAT if it makes taxable supplies in excess of the compulsory VAT registration threshold. See the definition of “enterprise” in 2.3 for more in this regard.
- Generally, a municipal entity does not conduct activities on behalf of a municipality, but rather for its own account. A municipal entity is therefore usually the principal for the purposes of any supplies which it makes and must account for VAT accordingly (unless it is specifically appointed as the agent of the municipality, in which case the rules of agency apply – see **Chapter 3**).
- A municipal entity falls within the meaning of the term “designated entity” as defined in section 1(1). Therefore, any payment made to a municipal entity, either by a municipality or a public authority, will include VAT at the standard rate to the extent that the payment relates to taxable supplies made by the municipal entity.

Only certain municipal entities that supply electricity/power, gas, water or refuse removal are allowed to account for VAT on the payments basis.

## 7.6 Water Boards

Water boards are not municipal entities, nor are they municipalities. Water boards are public entities and they are all listed in Schedule 3B to the Public Finance Management Act 1 of 1999 as National Government Business Enterprises.

A water board also falls within the definition of “designated entity” and therefore the VAT treatment of these entities is very similar to municipal entities as discussed in 7.5 above. Water boards may, upon application, be allowed to account for VAT on the payments basis.

## 7.7 Foreign donor funded projects

The definition of “person” in section 1(1) includes a “foreign donor funded project” previously referred to as a FDFP. An FDFP is a project established to give effect to an international donor funding agreement<sup>19</sup> that is binding on the Republic, under section 231(3) of the Constitution. Such agreements provide that any donated funds cannot be used to pay for any taxes imposed under South African Law.

The person appointed by the foreign donor as being responsible for administering the international donor funding agreement and carrying out the project may register for VAT so that any VAT incurred for the purposes of the project can be refunded through the VAT system as “input tax”.

An FDFP is regarded as a separate person for VAT purposes. This means that if the FDFP is administered by a public authority or municipality, the FDFP itself qualifies to be registered for VAT regardless of the VAT status of the public authority or municipality that manages its activities. Any input tax deductions in this regard are limited to the VAT incurred on goods or services acquired by the FDFP directly in connection with the implementation of the project. As discussed in 5.4 the input tax relating to the acquisition of motor cars and entertainment may be deducted by FDFPs, even though they are generally disallowed for other vendors.

This special provision does not entitle the public authority or municipality that administers or implements the project to deduct input tax on its normal VAT-inclusive capital and operating costs. In light of the fact that the FDFP and public authority or municipality (as the case may be) are separate persons, both parties are required to account for output tax on supplies made to each other. The deduction of input tax by the parties concerned on such supplies will depend on the status of the entity. For example, a public authority is usually not a vendor and will not deduct input tax nor charge VAT on any supplies made. In the case of a municipality, the rules as discussed in this guide regarding the deduction of input tax and the declaration of output tax will apply. For example, if any goods or services are supplied by the FDFP, the deduction of input tax by the municipality will depend on whether or not the goods or services are acquired for taxable purposes (subject to the normal documentary requirements for the deduction of input tax). Similarly, any taxable supplies made by the municipality to the FDFP will attract VAT at the standard rate and the FDFP may deduct input tax in accordance with the rules discussed in this paragraph (subject to the normal documentary requirements for the deduction of input tax).

For further information on FDFPs see the *VAT 404 – Guide for Vendors* and Interpretation Note 39.

## 7.8 Integrated Rapid Public Transport Network

Integrated Rapid Public Transport Network (IRPTN) is a public transport network that streamlines numerous transport modal options into a single coherent package. The intended modes of integrated transport include Metrorail services, conventional bus services, minibus taxi integration, feeder bus services, improved pedestrian and bicycle access, metered taxi integration and park-and-ride facilities.

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<sup>19</sup> Also known as Official Development Agreements and are international agreements for the donation of funds for use in the supply of goods or services to beneficiaries.

The National Department of Transport has identified certain metropolitan cities for an Integrated Rapid Public Transport Network to support the economic development of the area and some of the relevant municipalities have started with the progressive implementation of the IRPTN.

The most significant changes brought about by the implementation of the IRPTN is the introduction of rapid bus transit systems, dedicated right-of-way infrastructure (including dedicated transport lanes), increased security and surveillance infrastructure and Public Transport Information Technology. The public transport infrastructure and systems grant is the main funding source for the introduction of the bus rapid transit systems.

The supplies underlying the provision of the IRPTN may be acquired for taxable, exempt or mixed purposes. Providing public transport services to fare-paying passengers is an exempt supply for VAT purposes. However, the installation and maintenance of the IRPTN infrastructure by municipalities may form part of either their taxable activities or services rendered in accordance with the receipt of grant funding from the National Department of Transport.

The implementation and operation of the IRPTN may result in municipalities incurring mixed expenses. As discussed in **Chapter 5** above, municipalities must apply their apportionment ratio to the input tax incurred on mixed expenses as directed by BGR 4.

## 7.9 Rulings

The Tax Administration Act resulted in all VAT rulings and VAT class rulings being issued under section 41B of the VAT Act, read with Chapter 7 of the Tax Administration Act.<sup>20</sup> Applications for VAT class rulings and VAT rulings must be sent to SARS either by email to **VATRulings@sars.gov.za** or facsimile on 086 540 9390. The application should be headed “Application for a VAT Class Ruling” or “Application for a VAT Ruling”.

Any “person” as defined in section 1(1), including a municipality, who is, or intends to be, a party to a proposed, current or a past transaction may apply for a ruling in connection with that transaction. Where an agent, such as a lawyer or accountant files an application on behalf of a client, a Power of Attorney<sup>21</sup> or equivalent written statement must be submitted, in terms of which, the applicant (client) authorises the agent to file the application and act as the applicant’s representative throughout the application and ruling process. A person may also file an application in his or her capacity as a representative taxpayer. An application may not be filed by or on behalf of a person who is not, or does not intend to be, a party to the proposed or past transaction in question.

SARS may reject a ruling application in the circumstances listed in section 80(1) of the Tax Administration Act<sup>22</sup> or if it concerns an issue that is published in Government Notice 103.

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<sup>20</sup> The reference to advance tax rulings has changed with the implementation of the Tax Administration Act and is now being referred to as an advance ruling.

<sup>21</sup> The relevant form is the *General Power of Attorney Form*, available on the **SARS website**.

<sup>22</sup> SARS will only issue VAT rulings only to compliant taxpayers. This means that the tax affairs, of the applicants (including co-applicants where applicable), for all taxes administered by the Commissioner must be in order before SARS will accept an application and issue a VAT ruling, VAT class ruling or an advanced tax ruling.

The ruling application must be accompanied by all the relevant information, such as:

- The applicant's name, VAT registration number (if applicable), Company/Close Corporation/Trust Fund registration number or Identity Number, postal address, email address and telephone number.
- The applicant's tax practitioners name, postal address, email address and telephone number, if applicable.
- A description of the class members where applicable.
- A full and accurate description of the transaction (including financial implications).
- The impact the transaction might have upon the tax liability of the applicant or class members or if relevant, any connected person in relation to the applicant or class member.
- Any other transaction that was entered into before the application was filed or that the applicant may enter into after filing the application, if that other transaction may have a bearing on the tax consequences of the transaction, or may be considered to be part of a series of transactions involving the transaction.
- The relevant statutory provision(s) or issue(s).
- The reasons why the applicant believes the specific ruling(s) should be granted.
- The applicant's interpretation of the relevant statutory provision or issues, as well as an analysis of any relevant authorities that the applicant considered or is aware of, whether or not it supports the specific ruling(s) the applicant is seeking.

For more details about how to apply for a ruling, see the *Quick Reference Guide on VAT Ruling Application Procedure*.

## Glossary

**Consideration** Means the total amount of money (including VAT) received for a supply.

“Consideration” is widely defined to include any form of payment and any act or forbearance, whether or not voluntary, for the inducement of a supply of goods or services. Where the consideration is not in money, (for example, in the case of barter transactions), the consideration is the open market value of the goods or services (including VAT) received for making the taxable supply.

Section 10 determines the value of a supply for VAT purposes in respect of various types of supplies which allows one to determine the consideration.

The term “consideration” excludes –

- any donation made to an association not for gain; and
- a deposit which is lodged to secure a future supply of goods or services, which has not yet been applied as payment (for example, a deposit held in trust until the time of the supply is triggered under section 9), or which has not yet been forfeited.

**Enterprise** Includes any business or activity in the broadest sense. The enterprise or activity must contain the following crucial elements:

- It must be 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.

The following are some examples of activities which are not “*enterprise*” activities and which will accordingly not attract VAT:

- Services rendered by an employee to an employer, for example, salary/wage/remuneration earners (excluding independent contractors).
- Any activity involving the making of exempt supplies (that is, those listed in section 12).

**Exempt supplies** Refers to a supply on which VAT may not be charged (even if the supplier is registered for VAT). Persons making only exempt supplies may not register for VAT and may not deduct input tax on expenses incurred for the purpose of making these supplies.

Section 12 contains a list of exempt supplies. Some examples are –

- the supply of financial services as set out in section 2;
- rental of accommodation in any “*dwelling*”, including employee housing;
- the transport of fare-paying passengers and their personal effects by road or railway; and
- certain educational services.

**Goods**

Includes –

- corporeal (tangible) movable things, goods in the ordinary sense (including any real right in those things);
- fixed property, for example, land and buildings;
- any real right in fixed property, for example, servitudes, mineral rights, notarial leases etc;
- sectional title units (including timeshare);
- shares in a share block company;
- electricity;
- postage stamps; and
- second-hand goods.

The term excludes –

- money, that is, notes, coins, cheques, bills of exchange, etc (except when sold as a collector's item);
- value cards, revenue stamps etc which are used to pay taxes (except when sold as a collector's piece or an investment article); and
- any right under a mortgage bond or pledge.

**Input tax**

Includes, for example –

- VAT paid or payable by the recipient to a vendor in respect of the acquisition of taxable goods or services;
- VAT paid on the importation of goods by a vendor; and
- “Notional input tax”, being the tax fraction of the lesser of the consideration in money paid or the open market value of any second-hand goods acquired from a resident under a non-taxable supply (for example, a vendor's private asset which does not form part of the assets of any “*enterprise*” carried on).

Certain conditions may however apply, for example –

- input tax may only be deducted by the recipient if the goods or services are acquired for making taxable supplies (hence, no input tax may be deducted when goods or services are acquired for exempt or other non-taxable purposes);
- where goods or services are acquired only partly for the purpose of making taxable supplies, an apportionment of the VAT incurred must be made in order to determine the input tax; and
- in the case of second-hand goods (including fixed property) acquired under a non-taxable supply, special rules apply which limit the input tax deduction to the extent that the consideration has been paid.

The recipient must retain the relevant supporting documentation in order to deduct input tax, for example –

- the recipient must be in possession of a valid tax invoice as envisaged

in section 20; and

- in the case of second-hand goods, the recipient must keep a declaration by the supplier (form VAT 264) stating whether the supply is taxable or not and must maintain certain other records containing sufficient details of the transaction.

**Municipal entity**

An entity formed by a municipality for the purposes of better delivery of goods or services to the community and constitutes a separate legal entity to the municipality.

A “municipal entity” as defined in section 1 of the Local Government: Municipal Systems Act 32 of 2000, provides that a municipality may establish the following entities:

- A private company in which a municipality, or two or more municipalities collectively, have effective control.
- A service utility which is a juristic person under the sole control of the municipality which established it.
- A multi-jurisdictional service utility which is a juristic person under the shared control of the parent municipalities (the two or more municipalities who established the service utility by written agreement).

**Municipality**

As defined in the VAT Act, refers to municipalities falling into the categories listed in section 155(1) of the Constitution and which is an organ of state within the local sphere of government exercising legislative and executive authority within an area determined in terms of the Local Government: Municipal Demarcation Act 27 of 1998.

The categories are –

- Category A: A municipality that has exclusive municipal executive and legislative authority in its area (that is, a metropolitan municipality);
- Category B: A municipality that shares municipal executive and legislative authority in its area with a Category C municipality within whose area it falls (that is, a local municipality); and
- Category C: A municipality that has municipal executive and legislative authority in an area that includes more than one municipality (that is, a district municipality).



<b>Municipal rate</b>	<p>Refers to a rate levied by a municipality under section 2 of the Local Government: Municipal Property Rates Act 6 of 2004 (the Rates Act), on “<i>rateable property</i>” of an “<i>owner</i>” in the municipal area. Section 2 of the Rates Act provides that metropolitan and local municipalities may levy a rate on properties in its areas. A district municipality may only levy a rate on property in its district management [that is, part of a district municipality which under section 6 of the Municipal Structures Act 117 of 1998 has no local municipality and is governed by that municipality alone] area within the municipality.</p> <p>A municipality must exercise its powers to levy a rate on property subject to section 229 of the Constitution and any other applicable provisions of the Constitution. Section 229 of the Constitution provides, amongst others, that the municipality may not exercise its power in a way that materially and unreasonably prejudices national economic policies, economic activities across municipal boundaries, or the national mobility of goods, services, capital or labour. Rateable property as defined in the Rates Act means property on which a municipality may levy a rate under section 2 of the Rates Act, excluding property fully excluded from the levying of rates under section 17 of the Rates Act.</p> <p>A “municipal rate” as defined in the VAT Act excludes a single charge (a “flat rate” or an all-inclusive rate) levied by the municipality for rates and other supplies of goods or services such as electricity, gas, water, drainage or the removal or disposal of sewage.</p>
<b>mSCOA</b>	<p>This is an acronym for the uniform and standardised financial transaction classification framework, which is currently being developed by National Treasury for use by municipalities and municipal entities. mSCOA must be implemented by 1 July 2017.</p>
<b>Output tax</b>	<p>Refers to the tax (VAT) which is charged by a vendor on a taxable supply and is declared in the Part A of the VAT 201 return. Input tax and other deductions are deducted from the output tax liability to arrive at the net VAT payable (or refundable) for any particular tax period.</p>
<b>Person</b>	<p>Refers to the entity which is liable for VAT registration and includes –</p> <ul style="list-style-type: none"><li>• sole proprietors, that is, natural persons;</li><li>• companies and close corporations;</li><li>• partnerships;</li><li>• deceased and insolvent estates;</li><li>• municipalities;</li><li>• municipal entities;</li><li>• public authorities; and</li><li>• foreign donor funded projects.</li></ul>
<b>Recipient</b>	<p>Refers to the person to whom a supply of goods or services is made.</p>
<b>SARS</b>	<p>The acronym for “The South African Revenue Service”.</p>

- Services** Is broadly defined and includes –
- the granting, assignment, cession, and surrender of any right;
  - the making available of any facility or advantage; and
  - certain acts which are deemed to be services under section 8.
- The definition of “services” excludes –
- a supply of “goods”;
  - money; and
  - any stamp, form or card which falls into the definition of “goods”.
- Some examples of services are –
- commercial services such as services provided by electricians, plumbers, builders etc;
  - professional services such as services provided by lawyers; accountants and auditors; and
  - advertising services provided by advertising agencies.
- Supply** A “supply” is defined very broadly and includes all forms of supply, and any derivative of the term, irrespective of where the supply is effected. The term includes performance in terms of a sale, rental agreement and an instalment credit agreement and may be voluntary, compulsory or by operation of law.
- Some examples are –
- the expropriation of fixed property;
  - the letting of office buildings; and
  - the provision of a motor vehicle in terms of an instalment sale agreement.
- Taxable supplies** Includes all supplies which are chargeable with tax under the VAT Act. There are two types of taxable supplies, namely:
- Supplies which attract VAT at the zero rate (listed in section 11).
  - Supplies which attract VAT at the standard rate (that is, VAT charged at the rate of 14%).
- A taxable supply does not include any exempt supply listed in section 12, even if supplied by a registered vendor. Supplies made by persons who are not vendors (that is, not registered and not required to be registered for VAT) are also not taxable supplies.

**Tax invoice** A document which must be issued by the supplier in respect of taxable supplies made exceeding R50 and must be held by the recipient vendor in order to deduct input tax. Section 20 sets out the following information which is required to be reflected on the tax invoice:

Where the consideration exceeds R5 000, a full tax invoice under section 20(4) consisting of the following details is required:

- The words “tax invoice”, “VAT invoice” or “invoice”.
- The name, address and VAT registration number of the supplier.
- The name and address of the recipient as well as the VAT registration number of the recipient if that person is a vendor.
- The individual serialised number and the date of issue.
- An accurate description of the goods and/or services supplied.
- The quantity or volume of the goods or services supplied.
- The full consideration charged, and either –
  - the VAT amount shown separately; or
  - a statement that VAT is included, and the rate of VAT charged.

Where the consideration does not exceed R5 000, an abridged tax invoice under section 20(5) may be issued with the requirements being the same as above with the exception of the following particulars which may be omitted:

- The name, address and the VAT registration number of the recipient.
- The quantity or volume of the goods or services supplied.

A tax invoice is not required when the consideration in money does not exceed R50. However, a full tax invoice is required in respect of zero-rated supplies and not an abridged tax invoice.

**Tax period** A vendor must submit a VAT 201 return to SARS in respect of the tax period contemplated in section 27, in terms of which the vendor is registered.

A vendor may be required to account for VAT in terms of one of the following five categories of tax periods:

- Category A – two-monthly (ending at the end of every odd month, for example, January, March, May, July etc).
- Category B – two-monthly (ending at the end of every even month, for example, February, April, June etc).
- Category C – monthly (taxable supplies greater than R30 million per year).
- Category D – six-monthly (only certain farmers whose taxable supplies are less than R1.5 million per year).
- Category E – annually (only in exceptional circumstances where supplies are made to connected persons and payment of consideration only becomes due once a year).

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<b>Time of supply</b>	As a general rule, a supply is deemed to take place at the earlier of the time an invoice is issued, or the time any payment of consideration is received by the supplier. However, section 9 also provides for specific time of supply rules (for example, in respect of connected persons, periodic or progressive supplies, fixed property etc).
<b>Value of supply</b>	Normally means the price charged, excluding the VAT component. Section 10 also makes provision for specific valuation rules in certain cases (for example, certain supplies made between connected persons, or supplies made under instalment credit agreements, or where supplies are made which involve the issuing of tokens, vouchers or stamps).
<b>VAT</b>	The acronym for “Value-Added Tax”.
<b>VAT registration number</b>	The number allocated to a vendor by the Commissioner under section 24 of the Tax Administration Act.
<b>Vendor</b>	Refers to any person that is registered, or required to be registered for VAT. This means that any person making taxable supplies in excess of the threshold for compulsory registration prescribed in section 23 is a “vendor” as defined, regardless of whether or not the person is registered as such. Most municipalities and municipal entities will be registered (or liable to register) as vendors.

**Annexure A – Examples of “enterprise” activities**

The following is a list of supplies or income from supplies made by municipalities which are subject to VAT at the standard rate with effect from 1 July 2006 (the list is not exhaustive):

- The supply of electricity, gas or water.
- The drainage, removal or disposal of sewage or garbage.
- Upgrading/building of roads.
- Operating hospitals as principal.
- Abattoirs.
- Farming and forestry, for example the sale of trees or wood derived from trees removed from municipal owned forests.
- Parking grounds and garages.
- Produce markets.
- Township development.
- Escorting of abnormal vehicles by Metro Police.
- Airports.
- Quarries and the sale of sand.
- Cement-making.
- Caravan parks, pleasure and holiday resorts.
- Nurseries/hiking trails.
- Brickyards.
- Liquor sales.
- Provision of computer services.
- Game farms.
- Dog tax (fees).
- Cattle pens and auction facilities.
- Fee/refunds/commission received.
- Royalties.
- Library services.
- Museums and heritage buildings.
- Fire brigade services (fees).
- Provision of bus/taxi shelters and advertising services supplied in this regard.
- Issuing of licences or permits as principal.
- Entrance fee to recreational facilities.
- Letting of a bus, without a bus operator.
- Parks and recreational services.

- Connection and reconnection of electricity, water or gas (fees).
- By-products sales.
- Fees for making photostat copies of documents.
- Inspection/re-inspection (fees).
- Meter reading services.
- Signage and advertising.
- Trading (fees).
- Weighbridge.
- Industrial effluent/treatment effluent – sales.
- Subdivisions/zoning/re-zoning (fees).
- Recoveries of infrastructure maintenance.
- Removal of restrictions (for example, in a title deed in respect of a building site).
- Encroachment (fees) (for example, on the purchase or letting of a roadway/path which cuts through an erf).
- Burial fees/grave sales/cremation fees/cemetery fees.
- Filming (fees).
- Informal trading levy/trade licence.
- Recoupment: telephone/parking from staff.
- Banana ripening.
- Salvage items.
- Advertising.
- Roadworthy application/certificate.
- Fishing permit.
- Boat registration.
- Licensing and regulation: trading.
- Duplicate certificates.
- Selling of animals, birds, fish, trees or plants.
- Street frontage administration fee.
- Towing fees.
- Letting of commercial buildings, for example, offices, halls or shops.
- The supply of accommodation in a hostel or boarding establishment (commercial accommodation).
- Actual services rendered by one municipality to another municipality.
- Actual or deemed services rendered to a municipal entity.
- Intra-municipality service charges (only where the division of the municipality is registered separately for VAT purposes).

- Agency fees for acting as collecting and issuing agents for Province (for example, motor licences).

## Annexure B – Extracts from the Constitution (the Constitution of the Republic of South Africa, Act 108 of 1996)

The relevant sections of the Constitution, are quoted below:

### 1. Sections 155(2), (3), (6) and (7): Establishment of municipalities.

<p>...</p> <p>(2) National legislation must define the different types of municipality that may be established within each category.</p> <p>(3) National legislation must—</p> <ul style="list-style-type: none"> <li>(a) establish the criteria for determining when an area should have a single category A municipality or when it should have municipalities of both category B and category C;</li> <li>(b) establish criteria and procedures for the determination of municipal boundaries by an independent authority; and</li> <li>(c) subject to section 229, make provision for an appropriate division of powers and functions between municipalities when an area has municipalities of both category B and category C. A division of powers and functions between a category B municipality and a category C municipality may differ from the division of powers and functions between another category B municipality and that category C municipality.</li> </ul> <p>...</p> <p>(6) Each provincial government must establish municipalities in its province in a manner consistent with the legislation enacted in terms of subsections (2) and (3) and, by legislative or other measures, must—</p> <ul style="list-style-type: none"> <li>(a) provide for the monitoring and support of local government in the province; and</li> </ul> <p>(7) The national government, subject to section 44, and the provincial governments have the legislative and executive authority to see to the effective performance by municipalities of their functions in respect of matters listed in Schedules 4 and 5, by regulating the exercise by municipalities of their executive authority referred to in section 156(1).</p>
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### 2. Section 156(1): Powers and functions of municipalities.

<p>(1) A municipality has executive authority in respect of, and has the right to administer—</p> <ul style="list-style-type: none"> <li>(a) the local government matters listed in Part B of Schedule 4 and Part B of Schedule 5; and</li> <li>(b) any other matter assigned to it by national or provincial legislation.</li> </ul>
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### 3. Section 229(1), (2) and (3): Municipal fiscal powers and functions.

- (1) Subject to subsections (2), (3) and (4), a municipality may impose—
- (a) rates on property and surcharges on fees for services provided by or on behalf of the municipality; and
  - (b) if authorised by national legislation, other taxes, levies and duties appropriate to local government or to the category of local government into which that municipality falls, but no municipality may impose income tax, value-added tax, general sales tax or customs duty.
- (2) The power of a municipality to impose rates on property, surcharges on fees for services provided by or on behalf of the municipality, or other taxes, levies or duties—
- (a) may not be exercised in a way that materially and unreasonably prejudices national economic policies, economic activities across municipal boundaries, or the national mobility of goods, services, capital or labour; and
  - (b) may be regulated by national legislation.
- (3) When two municipalities have the same fiscal powers and functions with regard to the same area, an appropriate division of those powers and functions must be made in terms of national legislation. The division may be made only after taking into account at least the following criteria:—
- (a) The need to comply with sound principles of taxation.
  - (b) The powers and functions performed by each municipality.
  - (c) The fiscal capacity of each municipality.
  - (d) The effectiveness and efficiency of raising taxes, levies and duties.
  - (e) Equity.

### 4. Part A of Schedule 4: Functional Areas of Concurrent National And Provincial Legislative Competence

#### PART A

Administration of indigenous forests  
 Agriculture  
 Airports other than international and national airports  
 Animal control and diseases  
 Casinos, racing, gambling and wagering, excluding lotteries and sports pools  
 Consumer protection  
 Cultural matters  
 Disaster management  
 Education at all levels, excluding tertiary education  
 Environment  
 Health services  
 Housing

Indigenous law and customary law, subject to Chapter 12 of the Constitution

Industrial promotion

Language policy and the regulation of official languages to the extent that the provisions of section 6 of the Constitution expressly confer upon the provincial legislatures legislative competence

Media services directly controlled or provided by the provincial government, subject to section 192

Nature conservation, excluding national parks, national botanical gardens and marine resources

Police to the extent that the provisions of Chapter 11 of the Constitution confer upon the provincial legislatures legislative competence

Pollution control

Population development

Property transfer fees

Provincial public enterprises in respect of the functional areas in this Schedule and Schedule 5

Public transport

Public works only in respect of the needs of provincial government departments in the discharge of their responsibilities to administer functions specifically assigned to them in terms of the Constitution or any other law

Regional planning and development

Road traffic regulation

Soil conservation

Tourism

Trade

Traditional leadership, subject to Chapter 12 of the Constitution

Urban and rural development

Vehicle licensing

Welfare services

#### **6. Part B of Schedule 4: Functional Areas of Concurrent National And Provincial Legislative Competence**

##### **PART B**

The following local government matters to the extent set out in section 155(6)(a) and (7):

Air pollution	Building regulations	Child care facilities
Electricity and gas reticulation	Fire-fighting services	Local tourism
Municipal airports	Municipal planning	Municipal health services
Municipal public transport		

Municipal public works only in respect of the needs of municipalities in the discharge of their responsibilities to administer functions specifically assigned to them under this Constitution or any other law

Pontoons, ferries, jetties, piers and harbours, excluding the regulation of international and national shipping and matters related thereto

Stormwater management systems in built-up areas

Trading regulations

Water and sanitation services limited to potable water supply systems and domestic wastewater and sewage disposal systems

## **7. Part A of Schedule 5: Functional Areas of Exclusive Provincial Legislative Competence**

### **PART A**

Abattoirs

Ambulance services

Archives other than national archives

Libraries other than national libraries

Liquor licences

Museums other than national museums

Provincial planning

Provincial cultural matters

Provincial recreation and amenities

Provincial sport

Provincial roads and traffic

Veterinary services, excluding regulation of the profession

## **8. Part B of Schedule 4: Functional Areas of Exclusive Provincial Legislative Competence**

### **PART B**

The following local government matters to the extent set out for provinces in section 155(6)(a) and (7):

Beaches and amusement facilities

Billboards and the display of advertisements in public places

Cemeteries, funeral parlours and crematoria

Cleansing

Control of public nuisances

Control of undertakings that sell liquor to the public

Facilities for the accommodation, care and burial of animals

Fencing and fences

Licensing of dogs

Licensing and control of undertakings that sell food to the public

Local amenities

Local sport facilities

Markets

Municipal abattoirs

Municipal parks and recreation

Municipal roads

Noise pollution

Pounds

Public places

Refuse removal, refuse dumps and solid waste disposal

Street trading

Street lighting

Traffic and parking

**Annexure C – Binding General Ruling (VAT) 4 (Issue 3)****BINDING GENERAL RULING (VAT): NO. 4**

DATE : 27 March 2015

ACT : VALUE-ADDED TAX ACT NO. 89 OF 1991

SECTION : SECTION 1(1) – DEFINITION OF “INPUT TAX”

SUBJECT : APPORTIONMENT METHODOLOGY TO BE APPLIED BY A MUNICIPALITY

***Preamble***

For the purposes of this ruling –

- “**BGR**” means a binding general ruling issued under section 89 of the Tax Administration Act 28 of 2011;
- “**municipality**” means any municipality falling within any of the categories of municipalities described in section 155 of the Constitution of the Republic of South Africa, 1996;
- “**section**” means a section of the VAT Act unless otherwise stated;
- “**VAT**” means value-added tax;
- “**VAT Act**” means the Value-Added Tax Act 89 of 1991; and
- any other word or expression bears the meaning ascribed to it in the VAT Act.

**1. Purpose**

This BGR –

- prescribes the apportionment method, as contemplated in section 17(1), that a municipality must use to determine the amount of VAT which may be deducted as input tax on any goods or services acquired for a mixed purpose;<sup>23</sup> and
- replaces and withdraws BGR 4 (Issue 2) dated 25 March 2013 “Apportionment Methodology to be Applied by Category A and B Municipalities”.

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<sup>23</sup> For purposes of this BGR the acquisition of goods or services partly for the purpose of consumption, use or supply in the course of making taxable supplies and partly for another intended use will be referred to as a “mixed purpose”.

## 2. Background

VAT must be imposed at the standard rate under section 7(1)(a) on supplies made in the course or furtherance of carrying on an enterprise. However, the levying of VAT is subject to certain exemptions and exceptions. Some supplies made by a municipality are subject to VAT at 0% under section 11 (for example, grants, municipal property rates etc), or exempt from VAT under section 12 (for example, the transportation of passengers in a bus, the rental of dwellings etc).

In addition, there are some supplies and some forms of income that fall outside the scope of VAT. This include, for example –

- certain supplies that are not made in the course or furtherance of the municipality's enterprise such as the sale of assets on which input tax was denied under section 17(2) or that were used to conduct exempt supplies;<sup>24</sup> and
- certain income streams such as dividends, statutory fines and penalties that do not constitute consideration for any supply of goods or services made by the municipality.<sup>25</sup>

In this regard the *VAT 419 – Guide for Municipalities* sets out the application of the VAT Act to, amongst others, supplies made by and to municipalities.

## 3. The law and its application

The definition of “input tax” requires the principle of “direct attribution” to be applied. This means that the expense must first be allocated according to the intended purpose for which the expense is incurred, that is, whether it is related wholly to the making of taxable supplies or wholly to the making of exempt or out-of-scope supplies. Expenses that are incurred partly for the purpose of making taxable supplies must be allocated to a mixed purpose.

The VAT incurred on expenses acquired for a mixed purpose may be deducted as input tax to the extent determined in accordance with an apportionment method as contemplated in section 17(1) (that is, determined in accordance with a ruling contemplated in section 41B or Chapter 7 of the Tax Administration Act, 2011).

## 4. Ruling

- 4.1 A Municipality must use the turnover-based method of apportionment to determine the amount of VAT to be deducted as input tax on the acquisition of goods or services for a mixed purpose.
- 4.2 The apportionment formula (the Formula) which must be applied to determine the amount of input tax contemplated in 4.1 is as follows:

$$y = \frac{a}{a + b + c} \times \frac{100}{1}$$

<sup>24</sup> These are supplies which are neither taxable nor exempt. They are generally referred to as “out-of-scope supplies”.

<sup>25</sup> These income streams are generally referred to as “income from non-supplies”.

**Where:**

- “y” = the apportionment percentage/ratio;
- “a” = the value of all taxable supplies (including deemed taxable supplies) made during the period;
- “b” = the value of all exempt supplies made during the period, excluding interest earned on funds for day-to-day operations held in for example a current account at a bank; and
- “c” = the sum of any other amounts not included in “a” or “b” in the formula, that were received or accrued during the period (whether for a supply or not, for example, income received for out-of-scope supplies).

**Notes:**

1. The term “value” excludes any VAT component.
  2. In the Formula, “c” will typically include, but is not limited to, items such as statutory fines, penalties, dividends etc. However, traffic fines are only included in “c” to the extent that payment has actually been received by the municipality.
  3. Exclude from the calculation the value of any capital goods or services supplied, unless supplied under a rental agreement<sup>26</sup> (that is, not an instalment credit agreement<sup>27</sup>).
  4. Exclude from the calculation the value of any goods or services supplied where input tax on those goods or services was specifically denied under section 17(2).
  5. The apportionment percentage should be rounded off to 2 decimal places.
  6. Where the Formula yields a result equal to 95% or more, the full amount of VAT incurred for a mixed purpose may be deducted (the *de minimis* rule).
- 4.3 The following requirements and conditions apply in determining the amounts to be included in the Formula:
- 4.3.1 A grant that is received partly for taxable purposes and partly for non-taxable purposes must be attributed accordingly. For example, if 70% of a grant is for subsidising the taxable supply of water and electricity to customers and 30% is for subsidising the municipality’s exempt public transport business, the grant amount will have to be split into its respective taxable and non-taxable components in accordance with section 10(22). In this example, 70% of the grant amount will be subject to VAT at the zero rate and will be included in “a” in the Formula. The remaining 30% of the grant will be applied for exempt purposes and will be included in “b” in the Formula.
  - 4.3.2 Notwithstanding any permission which may have been granted by the Commissioner to allow a municipality to account for VAT on the payments basis under section 15(2)(a)(v), the amounts to be included in “a”, “b” and “c” in the Formula for each tax period and for the annual adjustment contemplated in **4.3.3** are to be calculated on the invoice basis and in accordance with the principles set out in the Accounting Standards

<sup>26</sup> See the definition of “rental agreement” in section 1(1).

<sup>27</sup> See the definition of “instalment credit agreement” in section 1(1).

Board's Standard of Generally Recognised Accounting Practice (GRAP) on *Revenue from Non-exchange Transactions (Taxes and Transfers)*, commonly referred to as GRAP 23. In terms of GRAP 23, income from government grants and subsidies is only recognised when the conditions (if any) are met. Grant income will therefore only be included in the Formula to the extent that such funds are reflected in the income statement of the municipality for the financial year concerned.

- 4.3.3 Although the apportionment percentage is applied in each tax period, for practical purposes, a municipality may calculate the percentage based on the previous year's financial statements. The percentage so calculated must then be applied in every tax period throughout the new financial year as an estimate. The apportionment percentage that was used as an estimate must be re-calculated in accordance with the municipality's audited financial statements and the necessary VAT adjustment made within six months after the municipality's financial year-end.
- 4.3.4 A municipality that is unable to perform the re-calculation and adjustment within the six-month period referred to in **4.3.3** must approach the Commissioner and request an extension by submitting a VAT ruling application by e-mail to **VATRulings@sars.gov.za** or by facsimile to 086 540 9390. All ruling applications made under section 41B must comply with section 79 of the Tax Administration Act, 2011, excluding section 79(4)(f) and (k) and (6).
- 4.3.5 The formal assignment of functions by national or provincial government falls within the ambit of the "enterprise" activities carried on by a municipality, provided the activity does not fall within the ambit of section 12. Any consideration charged, must be included in "a" in the Formula. Any payment received as a result of the national or provincial government providing financial assistance to enable the municipality to carry out the formally assigned activity is regarded as a "grant" as defined and must be included in "a" in the Formula.
- 4.3.6 The activities for which a municipality is appointed as agent by provincial government do not fall within the ambit of the enterprise carried on by the municipality. Only the amount charged for the taxable supply of such agency service to provincial government must be included in "a" in the Formula.
- 4.4 The VAT incurred and paid for directly on the supply of goods or services associated with provincial government mandates, referred to as "unfunded mandates", is regarded as being incurred in the course or furtherance of the municipality's enterprise, provided the provincial government mandated activity is not exempt under section 12. The VAT may be deducted in full when the expenses concerned are incurred wholly for purposes of use, consumption or supply in the course of making taxable supplies. Alternatively, the VAT may be deducted in part in accordance with the Formula if the expenses concerned are incurred for mixed purposes.
- 4.5 The deduction of input tax in all cases is subject to the documentary and other requirements set out in sections 16(2), 16(3), 17 and 20 being met.



4.6 The Commissioner may, on written application, consider the exclusion of **extraordinary income**<sup>28</sup> which may create a distortion in the Formula. The written application for a VAT ruling under section 41B must be submitted to the centralised e-mail address or facsimile number referred to in **4.3.4**.

**5. Period for which this ruling is valid**

This BGR is effective from 1 July 2014 and will apply until it is withdrawn or the relevant legislation is amended.

**Executive: Legal Advisory**

**Legal Counsel**

**SOUTH AFRICAN REVENUE SERVICE**

Date of 1st issue : 21 January 2010

Date of 2nd issue : 25 March 2013

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<sup>28</sup> This would generally be non-recurring income due to exceptional circumstances.

## Contact details

The **SARS website** contains contact details of all SARS branch offices and border posts.

Contact details appearing on the website under “Contact Us” (other than branch offices and border posts) are reproduced below for your convenience.

### SARS Head Office

#### Physical Address

South African Revenue Service  
Lehae La SARS  
299 Bronkhorst Street  
Nieuw Muckleneuk  
0181  
Pretoria

#### Postal Address

Private Bag X923  
Pretoria  
0001  
South Africa

#### SARS website

[www.sars.gov.za](http://www.sars.gov.za)

#### Telephone

(012) 422 4000

#### SARS Fraud and Anti-Corruption hotline

0800 00 28 70

### SARS Large Business Centre (LBC) Head Office

#### Physical Address

Megawatt Park  
Maxwell Drive  
Sunninghill  
Johannesburg

#### Postal Address

Private Bag X170  
Rivonia  
2128  
South Africa

#### Telephone

(011) 602 2010

#### email

[LBC@sars.gov.za](mailto:LBC@sars.gov.za)

For the contact details of each LBC sector go to “Contact Us” on the **SARS website** then go to “SARS Large Business Centre”.

### SARS Complaints Management Office (CMO)

#### Telephone

0860 12 12 16

Via eFiling, see our step-by-step guide  
Visit your nearest SARS Branch.

### e-Filing

#### Sharecall

0860 709 709

#### Cellular

082 234 8000

#### Fax

(011) 361 4444

#### email

[info@sarsefiling.co.za](mailto:info@sarsefiling.co.za)

#### Website

[www.efiling.gov.za](http://www.efiling.gov.za)

### National Call Centre

Please note:

- All the e-mail addresses and fax numbers displayed below are routed to the central SARS National Call Centre.
- If you are **not** a tax practitioner, and you have eFiling queries, you can contact the channel for the specific tax type you are dealing with (for example, VAT, PAYE, Income Tax etc) for assistance.

Query Type	Telephone	Fax	email
Income Tax	0800 00 7277	031 328 6011	<a href="mailto:it.cc@sars.gov.za">it.cc@sars.gov.za</a>
		021 413 8901	<a href="mailto:it.wc@sars.gov.za">it.wc@sars.gov.za</a>
Value-Added Tax (VAT)	0800 00 7277	021 413 8902	<a href="mailto:vat.wc@sars.gov.za">vat.wc@sars.gov.za</a>
Pay As You Earn (PAYE)	0800 00 7277	031 328 6013	<a href="mailto:paye.cc@sars.gov.za">paye.cc@sars.gov.za</a>
Tax Clearance Certificates	0800 00 7277	031 328 6048	<a href="mailto:tcc.kzn@sars.gov.za">tcc.kzn@sars.gov.za</a>
		021 413 8928	<a href="mailto:tcc.wc@sars.gov.za">tcc.wc@sars.gov.za</a>
Customs: General	0800 00 7277	031 328 6017	<a href="mailto:customs.gry@sars.gov.za">customs.gry@sars.gov.za</a>
		021 413 8909	<a href="mailto:cqry.wc@sars.gov.za">cqry.wc@sars.gov.za</a>
Tax Practitioners	0860 12 12 19	011 602 5049	<a href="mailto:pcc@sars.gov.za">pcc@sars.gov.za</a>
Tax Practitioners: eFiling	0860 12 12 19	011 602 5312	<a href="mailto:pccefiling@sars.gov.za">pccefiling@sars.gov.za</a>

### VAT Rulings

Should there be any aspects relating to VAT on which a specific VAT ruling is required, you may submit a ruling application to SARS headed "Application for a VAT Class Ruling" or "Application for a VAT Ruling" by fax or email. All applications must comply with section 79 of the Tax Administration Act [excluding sections 79(4)(f) and (k) and (6)].

**Fax**  
+27 86 540 9390

**email**  
[VATRulings@sars.gov.za](mailto:VATRulings@sars.gov.za)