

**VAT 411**

## **Value-Added Tax**

---

Guide for Entertainment, Accommodation and Catering

## FOREWORD

This guide concerns the application of the value-added tax (VAT) law regarding supplies of goods or services which fall into the category of “*entertainment*” and serves as a supplement to the *VAT 404 Guide for Vendors* which deals with the general operation of VAT. 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.

As the term “*entertainment*” covers a very wide array of goods and services, it is not possible for the guide to cover all aspects of entertainment. It focuses its attention on businesses which supply accommodation, food, beverages and other goods and services which are necessary to provide some form of hospitality or entertainment experience.

**Chapter 1** sets out in more detail the scope of entertainment topics covered in this guide, but briefly, this guide focuses on -

- different types of supplies made by accommodation establishments, including meals and other domestic goods and services supplied together with the accommodation;
- supplies of food and beverages in restaurants, bars, hotels, or other entertainment environments; and
- catering services supplied to customers or employees in different circumstances.

The term “*entertainment*” when used in this guide is therefore intended to focus on these limited areas, but the reader should remember that the term has a much wider meaning.

All references to “the VAT Act” or “the Act” are to the Value-Added Tax Act, No. 89 of 1991, and references to “sections” are to sections in the Value-Added Tax Act, unless the context otherwise indicates. The terms “Republic”, “South Africa” or the abbreviation “RSA”, are used interchangeably in this guide as a reference to the sovereign territory of the Republic of South Africa, as set out in the definition of “*Republic*” in section 1 of the VAT Act.

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 for ease of reference.

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

- AS-VAT-08 – Guide for Registration of VAT Vendors
- Trade Classification Guide (VAT 403)
- Guide for Fixed Property and Construction (VAT 409)
- Share Block Schemes (VAT 412)
- Deceased Estates (VAT 413)
- Guide for Associations not for Gain and Welfare Organisations (VAT 414)
- Diesel Refund Guide (VAT 415)
- Guide for the Small Retailers VAT Package (VAT 416)
- Guide for Small Vendors (VAT 417)
- AS-VAT-02 – Quick Reference Guide (Diplomatic Refunds) (VAT 418)
- Guide for Municipalities (VAT 419)
- Guide for Motor Dealers (VAT 420)

The information in this guide is issued for guidance only and does not constitute a binding general ruling as contemplated in section 76P of the Income Tax Act, No. 58 of 1962, and sections 41A and 41B of the VAT Act unless otherwise indicated.

The information in this guide is based on the VAT legislation (as amended) as at the time of publishing and includes the amendments contained in the Taxation Laws Amendment Act, No. 17 of 2009 and the Taxation Laws Second Amendment Act, No. 18 of 2009, both of which were promulgated on 30 September 2009 (as per GG 32610 and GG 32611 respectively).

The previous edition of the Guide for Entertainment, Accommodation and Catering (VAT 411) is hereby withdrawn.

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 legal issue, you may –

- contact your local South African Revenue Service (SARS) branch;
- visit the SARS website at [www.sars.gov.za](http://www.sars.gov.za);
- contact your own tax advisors;
- if calling locally, contact the SARS National Call Centre on 0800 00 72 77 or
- if calling from abroad, contact the SARS National Call Centre on +27 11 602 2093.

Comments and/or suggestions regarding this guide may be e-mailed to [policycomments@sars.gov.za](mailto:policycomments@sars.gov.za).

Prepared by:

**Legal and Policy Division**  
**South African Revenue Service**

1 November 2009

## CONTENTS

<b>CHAPTER 1: INTRODUCTION</b>	<b>7</b>
1.1 Scope of entertainment topics	7
1.2 Approach of the guide	7
1.3 Background	8
<b>CHAPTER 2: CONCEPTS AND DEFINITIONS</b>	<b>11</b>
2.1 Accommodation	11
2.2 All-inclusive charge	11
2.3 Consideration	11
2.4 Commercial accommodation	12
2.5 Domestic goods and services	12
2.6 Dwelling	12
2.7 Enterprise	14
2.8 Entertainment	16
2.9 Supply	16
<b>CHAPTER 3: AGENT vs PRINCIPAL</b>	<b>18</b>
3.1 Introduction	18
3.2 Legal principles of agency	18
3.3 Tax invoices, credit notes and debit notes	19
3.4 Application of agency principles	20
<b>CHAPTER 4: GENERAL RULES ON ENTERTAINMENT</b>	<b>23</b>
4.1 Introduction	23
4.2 General rule: disallowance of input tax	23
4.3 Exceptions to the general disallowance rule	24
4.3.1 Introduction	24
4.3.2 Businesses supplying entertainment	24
4.3.3 Personal subsistence	29
4.3.4 Taxable transportation services	32
4.3.5 Seminars or similar events	32
4.3.6 Municipal recreational facilities	33
4.3.7 Welfare organisations	35
4.3.8 Medical care facilities	36

4.3.9	Ships' crew	36
4.3.10	Prizes	37
4.3.11	Foreign donor funded projects	38
<b>CHAPTER 5: COMMERCIAL ACCOMMODATION EXPLAINED</b>		<b>39</b>
5.1	Introduction	39
5.2	Paragraph (a) – Commercial establishments	39
5.3	Paragraph (b) – Old age homes and other care facilities	41
5.4	Paragraph (c) – Hospices	42
<b>CHAPTER 6: VAT TREATMENT OF ACCOMMODATION ESTABLISHMENTS</b>		<b>44</b>
6.1	Exempt accommodation	44
6.1.1	Introduction	44
6.1.2	Accommodation in a dwelling	44
6.1.3	Life rights	44
6.1.4	Lodging or board and lodging supplied by employers to employees	45
6.1.5	Lodging or board and lodging supplied by educational institutions	46
6.1.6	Other non-taxable supplies of accommodation	47
6.2	Taxable supplies of accommodation (before 1 October 2001)	47
6.2.1	Commercial rental establishments	47
6.2.2	Residential rental establishments	48
6.2.3	Application of the special value of supply rules	48
6.3	Taxable supplies of commercial accommodation (from 1 October 2001)	49
6.3.1	Overview of the amendments	49
6.3.2	Application of the special value of supply rules	50
6.4	Supplies to staff	52
6.4.1	Accommodation	52
6.4.2	Meals and refreshments	52
6.5	Other supplies	53
6.5.1	Entrance fees	53
6.5.2	Coin-operated machines and amusements	53
6.5.3	Hiring of facilities and miscellaneous sales	54
6.5.4	Guest transportation	54
6.5.5	Tips for baggage handling or other services	55
6.5.6	Laundry services	55

**CHAPTER 7: INVOICING, TIME AND VALUE OF SUPPLY 56**

7.1	Invoices and tax invoices	56
7.1.1	Introduction	56
7.1.2	Tax invoices issued by agents	56
7.1.3	Tax invoices issued to guests	56
7.1.4	Disbursements	56
7.2	Time of supply	57
7.2.1	General	57
7.2.2	Deposits and prepayments for advance bookings	57
7.2.3	Payment through agents	59
7.2.4	Coupons and vouchers	60
7.3	Value of supply	60
7.3.1	General rules	60
7.3.2	Special rules – accommodation establishments	60
7.3.3	Complimentary accommodation	60

**CHAPTER 8: RESTAURANTS AND CATERING BUSINESSES 61**

8.1	Introduction	61
8.2	Agents and principals	61
8.3	Restaurants, take-aways and franchises	62
8.4	Catering in factories, offices and other work places	62
8.4.1	Catering provided by the organisation itself	62
8.4.2	Outsourcing of the catering function	63
8.4.3	Catering provided by an agent	63
8.4.4	Caterers acting in a dual capacity	64
8.5	Catering in exempt educational institutions	64
8.5.1	Catering provided by the organisation itself	64
8.5.2	Outsourcing of the catering function	64
8.5.3	Catering provided by an agent	65
8.5.4	Caterers acting in a dual capacity	65
8.6	Catering in hospitals and other medical facilities	65
8.7	Catering on ships and aircraft	65
8.8	Catering on trains and buses	66
8.9	Catering at seminars and similar events	66
8.10	Other supplies of catering	67

<b>CHAPTER 9: CLUBS, ASSOCIATIONS AND SIMILAR BODIES</b>	<b>68</b>
9.1 Associations not for gain and welfare organisations	68
9.2 Donations, membership fees and entrance fees	69
9.3 Other charges for goods or services	71
<b>CHAPTER 10: ENTERTAINERS AND SPORTSPERSONS</b>	<b>72</b>
10.1 Introduction	72
10.2 Agents	72
10.3 Employees and independent contractors	73
10.4 Transfer fees	74
10.5 Intellectual property	74
10.6 Ticket sales	74
10.7 Stadiums	74
10.8 Refreshments provided to event participants	75
10.9 Levying of fines and penalties	75
<b>CHAPTER 11: MISCELLANEOUS ISSUES</b>	<b>77</b>
11.1 Introduction	77
11.2 Conferences and trade fairs	77
11.3 Employee housing	77
11.4 Subletting of dwellings	77
11.5 Sale of furnished flats	78
11.6 Promotional gifts	78
11.7 Recovery of costs	78
11.8 Supplies by educational institutions	78
11.9 Catering for film production crew	79
<b>GLOSSARY</b>	<b>80</b>
<b>ANNEXURE A – MEDIA RELEASE NO 45 OF 2001 : CHANGES TO VAT ON LONG TERM ACCOMMODATION IN HOTELS, BOARDING HOUSES, RETIREMENT HOMES AND SIMILAR ESTABLISHMENTS</b>	<b>84</b>
<b>ANNEXURE B – COMMON LAW DOMINANT IMPRESSION TEST GRID</b>	<b>85</b>
<b>CONTACT DETAILS</b>	<b>87</b>

# CHAPTER 1

## INTRODUCTION

### 1.1 SCOPE OF ENTERTAINMENT TOPICS

As mentioned in the **Foreword** of this guide, the term “*entertainment*” covers a very wide array of goods and services. To illustrate, the definition of “*entertainment*” in section 1 means “*the provision of any food, beverages, accommodation, entertainment, amusement, recreation or hospitality of any kind by a vendor whether directly or indirectly to anyone in connection with an enterprise carried on by him.*”

If one thinks of all the different types of entertainment supplies, and all the direct or indirect ways in which a person can be supplied with “*any food, beverages, accommodation, entertainment, amusement, recreation or hospitality*” as contemplated by the definition, the permutations are almost infinite. It has, therefore, been necessary to limit the scope of this guide so that it focuses attention on hospitality type businesses which supply entertainment in the form of accommodation, food, beverages, and associated goods and services.

Typically, this includes –

- different types of supplies made by accommodation establishments, including meals and other domestic goods and services supplied together with the accommodation (where applicable);
- supplies of food and beverages in restaurants, bars, hotels, or other entertainment environments; and
- catering services supplied to customers or employees at events and places of work, as well as some of the outsourcing arrangements in respect of those supplies.

The term “*entertainment*” when used in this guide is therefore intended to focus on these limited areas, but the reader should remember that the term has a much wider meaning when applying the VAT Act in a more general sense.

### 1.2 APPROACH OF THE GUIDE

The approach of this guide in dealing with the topics mentioned in **paragraph 1.1** is set out below.

**Chapter 1** – Explores the scope of the topic and some of the special rules regarding supplies of entertainment. The historical and legislative background is also briefly mentioned.

**Chapter 2** – Introduces the reader to the most important concepts, terms and definitions mentioned in the guide so that the VAT treatment of supplies which are explained in later chapters can be understood. A key point addressed in this chapter is the difference between the supply of accommodation in a dwelling (exempt supply) and the supply of commercial accommodation (taxable supply).

**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. These concepts are particularly important with regard to supplies of accommodation, catering and travel, which are often arranged through agents.

**Chapter 4** – Deals with supplies of entertainment in general and focuses on the special rules which deny the claiming of input tax on entertainment expenses, as well as the exceptions to these rules.



**Chapter 5** – Provides a detailed analysis of the definition “*commercial accommodation*” and highlights the different types of supplies and accommodation establishments contemplated in the definition.

**Chapter 6** – Explains the VAT treatment of the different types of supplies of exempt accommodation and taxable commercial accommodation. The chapter includes a discussion on the application of the special value of supply rule both before, and after, the amendments to the VAT law which came into effect on 1 October 2001.

**Chapter 7** – Deals with matters pertaining to the time and value of supplies, as well as the issuing of invoices and tax invoices, and how this impacts on the accounting of VAT.

**Chapter 8** – Focuses on the issues faced by catering businesses which supply food and beverages to customers as their main business, or as an ancillary part of carrying on another activity. Examples include restaurants, commercial caterers, employee and student canteens, and businesses which supply meals and refreshments as part of a transportation service.

**Chapter 9** – Discusses the supplies made by welfare organisations, clubs, associations, societies and similar bodies, as well as some special rules which apply to these entities.

**Chapter 10** – Deals with the VAT treatment of supplies made by entertainers, sportspersons and their agents.

**Chapter 11** – Discusses some of the other aspects regarding the supply of entertainment which are not dealt with in the other chapters.

Although some aspects of the supply of entertainment made by other vendors, such as casinos, welfare organisations, tour operators, municipalities, recreational clubs and associations not for gain will be touched on briefly in this guide, these will not be dealt with in detail. The same will apply where SARS has already issued a guide, interpretation note or other document explaining the VAT treatment of the supply of entertainment in certain situations. Where applicable, these other documents will be referred to in this guide, but the content will not be repeated unnecessarily.

For example, the following documents may be referred to for more information on specific entertainment topics:

- VAT 404 - Guide for Vendors.
- VAT 414 - Guide for Associations not for Gain and Welfare Organisations.
- Interpretation Note No. 41 – (Issue 2) (31 March 2008) – Application of VAT to the gambling industry.
- Interpretation Note No. 42 – (2 April 2007) – The supply of goods and/or services by the travel and tourism industry.

### 1.3 BACKGROUND

Most countries which have a VAT system of taxation have special rules regarding entertainment expenses incurred by vendors. The reasoning behind these special rules is that entertainment purchases are often subject to abuse because they have both a business and personal consumption component. Normally, these rules take the form of a denial of input tax on such expenses. However, as an input tax deduction should, in principle, not be denied in respect of legitimate business transactions, the denial of input tax is usually subject to a limited list of exceptions where certain specified conditions have to be met before input tax may be allowed.

Conceptually, the denial of input tax is linked to the idea that a vendor who provides entertainment should not be in a position to deduct the full amount of input tax in a situation where there is an element of personal consumption by that vendor, an employee of that vendor, or a connected person in relation to that vendor.

However, from an administrative point of view, it would be extremely difficult to apportion, or identify separately, the extent of that personal consumption so that the input tax deduction in relation to the total VAT incurred could be adjusted accordingly. Also, from a practical point of view, even if it is possible to identify the element of personal consumption through the application of some method, the wide array of subjective factors which would have to be considered would increase compliance costs.

The Value-Added Tax Committee (VATCOM) was a committee consisting of members from the private and public sectors, appointed by the Minister of Finance (the Minister) to consider the comments and representations made by interested parties in 1991 on the Government's draft Value-Added Tax Bill. VATCOM had the following to say in its Report (at page 24) in regard to representations received on how supplies of entertainment should be treated under the VAT system in South Africa:

*It is often extremely difficult to distinguish between entertainment expenses incurred for business purposes and those incurred for private purposes. Experience with income tax in South Africa and in other countries is that entertainment expenses claimed often only have a very tenuous link with business activities. Abuse of the deduction also often takes place. In addition, there is often an element of personal enjoyment built into the activities. For example, taking a client to a sporting event the businessman wishes to attend, club subscription of a golf club or a yacht of a company whose director enjoys sailing, all contain an element of personal enjoyment. It is impossible to determine accurately what this element is. For these reasons it was decided to disallow the input credit for these supplies. In addition, in most cases it will not have any effect on the cost of the goods or services as they are presently subject to GST. It would also place entertainment funded out of entertainment allowances given to employees, on the same footing as entertainment borne by vendor, as employees would not be able to claim an input credit.*

The recommendation of VATCOM (which was accepted) was that the South African legislation should follow a similar approach to most other countries so that credit for input tax attributable to entertainment purchases is generally disallowed, even if the purchases are incurred in the course of conducting enterprise activities. A vendor can therefore generally not deduct input tax in regard to any VAT incurred on country club or sports club membership fees, or on any food or beverages provided to employees or clients.

However, the obvious exception to the disallowance rule is where the vendor is in the business of supplying entertainment, and the taxable supply or importation relates to the supply of that entertainment in the ordinary course of conducting the business. Therefore, a supermarket or restaurant which sells various types of food and beverages is not subject to the disallowance rule on the purchase of these items because it is selling them in the ordinary course of its business.

The input tax deduction is also not disallowed if meals and refreshments are provided to passengers as part of a taxable transportation service, or to participants in a seminar or similar event, if the cost of providing that entertainment has been included in the price of the transportation service, or in the entrance fee for the seminar.

There are a limited number of other instances where the disallowance rule does not apply, but these will be discussed in more detail in **Chapter 4**. If the circumstances of a particular case are not covered in the list of exceptions, the input tax is usually denied, even if the element of personal consumption is negligible.

Other important general features of the VAT rules regarding supplies of entertainment are as follows:

- If entertainment expenditure is incurred for exempt or private purposes, the VAT incurred is not denied under the general disallowance rule, but rather, it does not qualify as input tax since it is wholly attributable to non-enterprise activities or purposes.
- Where the goods or services are acquired only partially for entertainment purposes, only that portion of the input tax deduction is denied.
- If entertainment goods or services were acquired with a taxable purpose in mind and input tax has been claimed thereon, an adjustment to input tax or output tax is required if the actual use or application is different from the original intended purpose. This includes stock taken by the vendor for own use, or for other non-taxable purposes.
- Where an input tax deduction on goods or services acquired for purposes of entertainment has been denied under the general disallowance rule, the value of any subsequent supply of that entertainment is deemed to be nil. In other words, no VAT will be levied on goods or services supplied where the VAT incurred on the original acquisition of those things was specifically denied. Therefore, where an employer provides free meals to employees, or charges a price which is less than an amount which covers all the direct and indirect costs of providing those meals, the employer will not charge VAT on any consideration paid by the employee.

The general features of the VAT system as it relates to the provision of entertainment and the deduction of input tax in relation to supplies of entertainment are discussed in more detail in **Chapter 4**.

## CHAPTER 2

### CONCEPTS AND DEFINITIONS

#### 2.1 ACCOMMODATION

The term "accommodation" is not defined in the VAT Act, and therefore, the ordinary meaning applies. According to The Concise Oxford Dictionary "accommodation" is defined as "*lodgings; a place to live*". In its ordinary meaning the word is therefore capable of being interpreted as –

- the mere supply of a place to live; or
- the supply of a place to live, including all the things that commonly go with the supply of a place to live.

In the context of the VAT Act the meaning of "accommodation" is not limited to the mere supply of a place to live but should include everything that, in the circumstances of that supply, can be said to be part of the supply of the accommodation. However, it can sometimes be difficult to distinguish between supplies that may be considered to be part of the supply of accommodation and a separate supply of other goods or services not being part of the supply of the accommodation. All the circumstances must be taken into account to determine whether supplies to an occupant or tenant are integral, ancillary or incidental to the supply of accommodation in a dwelling, or to a supply of commercial accommodation (including domestic goods and services) to the extent that it is appropriate to say they are part of that supply.<sup>1</sup>

#### 2.2 ALL-INCLUSIVE CHARGE

This concept "all-inclusive charge" is referred to in a special value of supply rule<sup>2</sup> which is applicable when commercial accommodation is supplied to a customer or resident together with domestic goods and services at an all-inclusive charge for a continuous period in excess of 28 days.

The term is not defined and therefore takes its ordinary meaning. The Encarta dictionary (English U.K.) defines the term "all-inclusive" as:

*including everything; including or encompassing everything that is expected or appropriate.*

It follows that an "all-inclusive charge" in the context of the application of the special value of supply rule, means a composite amount quoted or charged for the supply of commercial accommodation including any domestic goods and services included by the supplier, or expected by the guest as an integral, necessary, or ancillary part of the supply of accommodation.

#### 2.3 CONSIDERATION

The term "*consideration*" in its simplest form means anything that is received in return for the supply of goods or services. It therefore includes, for example, the cash payment in respect of the purchase price of goods, the giving of a post-dated cheque for the payment of services and the value of services received in return for providing goods under a barter transaction. However, specifically excluded from the ambit of consideration is a donation made to an association not for gain. Also, a "deposit" payment<sup>3</sup> whether refundable or not, given in respect of a supply of goods or services is not regarded as payment made for the supply<sup>4</sup> unless and until the supplier applies the deposit as consideration for the supply or the deposit is forfeited.

---

<sup>1</sup> Refer to **paragraph 2.6** for a more detailed discussion on the difference between the supply of a "dwelling", and the supply of "commercial accommodation", as well as **Chapter 5**.

<sup>2</sup> Refer to section 10(10).

<sup>3</sup> Refer to **paragraph 7.2.2** for a detailed discussion on deposits and prepayments.

<sup>4</sup> This excludes a deposit on a returnable container.

## 2.4 COMMERCIAL ACCOMMODATION

The definition of “*commercial accommodation*” was introduced with effect from 1 October 2001 to simplify the previous provisions which applied in relation to the supply of accommodation in hotels, boarding houses, retirement homes and similar establishments. This definition is fundamental in determining whether certain supplies of accommodation will be subject to VAT or not.

The term “*commercial accommodation*” refers to hospitality-type accommodation, and not to the letting of office space or premises from where the occupant will carry on a business activity. *Refer to Chapter 5 for a detailed discussion on the meaning of this term.*

## 2.5 DOMESTIC GOODS AND SERVICES

The term “*domestic goods and services*” is defined specifically for purposes of the application of a special value of supply rule referred to in **paragraph 2.2**. It refers to certain specified goods and services which are supplied to the occupant as an integral, necessary, or ancillary part of the supply of the accommodation, including cleaning and maintenance, electricity, gas, air conditioning or heating, the use of a telephone, television set or radio; furniture and other fittings, meals etc.

Domestic goods and services may be supplied separately for a separate consideration, or they may be supplied at an all-inclusive charge to the guest as an integral part of the supply of accommodation. In the latter case, only 60% of the all-inclusive charge will be subject to VAT at the standard rate if the guest stays for a period in excess of 28 days.

The full value of goods or services supplied by the accommodation establishment which do not fall within the definition of “*domestic goods and services*” (but which are not exempt or zero-rated) will always attract VAT at the standard rate whether included in the all-inclusive tariff or not. Not all supplies by an accommodation establishment qualify as domestic goods and services, but at the same time, the list of goods and services in the definition is not a complete list of everything that qualifies.

*Refer to Chapter 6 for a further discussion on the meaning of this term and the application of the law in regard to goods and services falling within, and outside the ambit of the definition.*

## 2.6 DWELLING

The supply of accommodation in a dwelling is exempt from VAT, whereas the supply of commercial accommodation is subject to VAT (if the supplier is a vendor). The supply of accommodation in a house, flat, room or part of a building which constitutes the place of residence of a natural person can constitute the supply of a dwelling. However, a similar type of supply in certain circumstances may constitute the supply of commercial accommodation. It is therefore important to examine the nature and characteristics of the supply as well as all the circumstances under which the supply is made to determine the VAT treatment.

Distinguishing characteristics which can be used as a guideline<sup>5</sup> to identify the supply of a dwelling as opposed to the supply of commercial accommodation are as follows:

---

<sup>5</sup> None of the listed characteristics constitutes a decisive test on its own, as it is not possible to prescribe an absolute rule to distinguish the supply of a “*dwelling*” from the supply of “*commercial accommodation*” in every possible circumstance. Although the definitions of “*dwelling*” and “*commercial accommodation*” in the VAT Act are mutually exclusive, from a practical point of view, certain supplies of accommodation may be difficult to classify under these definitions. For example, hotel accommodation supplied by a major hotel group is clearly commercial accommodation, whereas the supply of a house for use as a residence under a lease agreement is clearly the supply of a dwelling. Other types of accommodation might not be so easy to classify into either of these categories.

- A dwelling is a building or part thereof which is usually a self-contained unit not easily capable of subdivision into further self-contained accommodation units.
- A dwelling will typically have at least a kitchen, a bedroom and a bathroom;<sup>6</sup> and the occupant (lessee) will usually enter into a formal written lease agreement with the owner or lessor (although verbal agreements are equally binding on the parties).
- Accommodation in a dwelling is generally supplied for long periods<sup>7</sup>, whereas commercial accommodation is typically supplied for shorter periods.<sup>8</sup>
- Although not a requirement, the rental charge for a dwelling will typically exclude the supply of water and electricity by a municipality or similar service provider. In the case of commercial accommodation, the supply of water and electricity by the municipality, will in almost all cases, be to the person conducting the commercial establishment and not to the guest or resident.
- The owner or lessor of a dwelling unit is usually not expected to be in attendance at the property to cater for the needs of the lessee, or to supply domestic goods and services.
- The supply of furnishings and fittings is not usually a reliable indicator of whether the supply should be characterised as a dwelling or commercial accommodation. Commercial accommodation is almost always supplied together with the use of furniture and fittings, but these could also be supplied together with a dwelling under the lease agreement, for a fully or partially furnished dwelling.<sup>9</sup>
- When a dwelling is supplied, the owner or lessor grants possession of land and buildings by way of contract (a lease agreement) for a specified period in return for the payment of rent. For commercial accommodation, the accommodation unit is supplied by a commercially-run establishment providing lodging, or board and lodging to guests, and often contains a number of associated common areas from where the establishment provides other goods and services to guests (usually for additional consideration). For example, a bar, a restaurant, shops, currency exchange etc.
- Contractually, the supply of the use of a dwelling and any curtilage<sup>10</sup> for a consideration is a supply under leasehold tenure, and the lease agreement prescribes the acceptable purposes for which the property may be used by the lessee as a residence. Property held under a lease agreement entitles the lessee to the quiet enjoyment of the property without undue interference of the lessor. Commercial accommodation involves making available the use of an accommodation unit which forms part of the assets or resources of the accommodation establishment to the guest under a general agreement, understanding, or licence to occupy. The guest is subject to the rules<sup>11</sup> of the accommodation establishment which forms the basis of the terms and conditions of occupancy.

If residential units in a building are used to supply commercial accommodation, the units concerned will not constitute dwellings. Similarly, a dwelling supplied in terms of an agreement for the letting and hiring thereof is excluded from the definition of “*commercial accommodation*”. This makes the terms “*dwelling*” and “*commercial accommodation*” mutually exclusive.

---

<sup>6</sup> There may be some exceptions or variations, for example, in some cases there may be a common cooking area or shared bathroom facilities. An example is a garage which is converted to be suitable for human habitation. If the garage doesn't have a self-contained kitchen and bathroom, but these facilities are made available on another part of the property or shared with other residents, the converted garage may still qualify as a dwelling.

<sup>7</sup> Residential leases for dwellings are usually for periods of six months or more, although this does not exclude leases for shorter periods from qualifying as the supply of a dwelling. More typically, residential leases are for a fixed period of one to three years, often followed by a month-to-month arrangement (unspecified or indefinite period) or they are merely concluded on a month-to-month basis from inception, usually with a one or two month notice period for termination of the lease to be given by either party.

<sup>8</sup> Most hospitality type accommodation is supplied for periods of less than 28 days. However, in some cases (for example in old age homes and residential hotels), the accommodation may also be supplied for longer periods.

<sup>9</sup> For example, when the supply of a dwelling includes the use of appliances such as a stove or fridge, or the use of other fixtures, fittings or facilities included in the rental charge for the dwelling. Examples include fitted curtains, lounge furniture, the use of a swimming pool, garage, garden equipment or other household items.

<sup>10</sup> This is an enclosed area of land adjacent to a dwelling. It could include an exclusive use area attached to a dwelling, or an area forming part of the common property of a building in which the dwelling is situated.

<sup>11</sup> The rules are usually made available to guests in the form of a written notice handed to the guest upon checking in at reception, or posted in plain sight of the guest in all accommodation units forming part of the accommodation establishment. The establishment's rules are often found on the inside of the front door of the unit, in the kitchen, in a brochure listing various goods or services offered by the establishment, or in any other place in the unit where the guest is likely to see it.

## 2.7 ENTERPRISE

The term “*enterprise*” is very important in the context of the VAT Act, because –

- a person who does not conduct an enterprise cannot register for VAT;
- only supplies made in the course or furtherance of an enterprise (referred to as taxable supplies) are subject to VAT; and
- only VAT on expenses incurred for the purpose of consumption, use or supply in the course of making taxable supplies can be claimed as input tax.

The general rule is that if a person conducts an enterprise and the value of taxable supplies for any 12-month consecutive period exceeds R1 million,<sup>12</sup> or is likely to exceed this amount, the person is obliged to register for VAT. In cases where the value of taxable supplies is less than the threshold, but more than R20 000, the person may apply for voluntary registration. However, in the case of persons supplying commercial accommodation, the minimum threshold of taxable supplies is R60 000 and not R20 000.

In the context of supplies of commercial accommodation, it is critical to determine whether an enterprise activity is carried on or not as there are certain exemptions pertaining to the supply of accommodation (refer to **Chapter 6**).

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 the enterprise or activity, **goods or services** are **supplied** to another person.
- A **consideration is charged** for the goods or services supplied.

At this stage, the most critical elements to discuss are the words “continuously” or “regularly”. “Continuously” is generally interpreted as ongoing, that is, the duration of the activity has neither ceased in a permanent sense, nor has it been interrupted in a substantial way. The term “regular” refers to an activity that takes place repeatedly. Therefore, an activity can be “regular” if it is repeated at reasonably fixed intervals taking into consideration the type of supply and the time taken to complete the activities associated with making the supply.

### Example 1 – Registration as a business supplying commercial accommodation

#### Scenario

During April 2009 Ms S bought a house in Soweto which she intends refurbishing and converting into a guesthouse to take advantage of the accommodation needs of tourists in the Johannesburg area. According to her business plan, the guesthouse will be completed within the next four months, it will have 10 rooms, and she estimates that the potential income from the activity will be in the region of R800 000 per annum. She needs to make at least R450 000 per annum to cover all of her expected expenses.

#### Question

Does Ms S carry on an enterprise and can she register for VAT voluntarily?

*Continued overleaf ...*

<sup>12</sup> With effect from 1 March 2009 the compulsory registration threshold for VAT was increased from R300 000 to R1 million. Refer to VAT News No. 32 – August 2008 and VAT News No. 33 – February 2009 for more details in this regard. Note also that in terms of the Taxation Laws Amendment Act, No. 17 of 2009, the entry level threshold for voluntary VAT registration has been increased from R20 000 to R50 000 with effect from 1 March 2010 (except for vendors that supply “commercial accommodation”, in which case the voluntary registration threshold is R60 000).

**Example 1 (continued)***Answer*

Although Ms S has not actually made any taxable supplies yet, she is in the process of converting the house into a guesthouse. She also has ongoing expenses which she incurs in connection with the ultimate intention of supplying commercial accommodation and domestic goods and services. Ms S will therefore be engaged in a continuous activity involving the supply of commercial accommodation to guests on a continuous or regular basis. Since her business plan indicates that she needs to earn R450 000 to cover all of her expenses, it follows that the value of taxable supplies (commercial accommodation) must exceed the minimum registration threshold of R60 000 in a 12-month period for the businesses to survive. Although each case is based on its own merits, it would be reasonable to conclude on the information provided, that Ms S will qualify to register for VAT voluntarily.

However, Ms S must be able to demonstrate that she is actually committed to her intention of supplying commercial accommodation and that the notion of running a guesthouse is not merely an idea. Ms S will improve her prospects of being allowed to register voluntarily if she has persuasive evidence of her intention, such as the following –

- Approval of building plans passed by the municipality or proof that plans have been lodged.
- Building refurbishments have been completed, have commenced, or that a contract has been concluded to carry out the work.
- Contracts have been concluded in connection with the business. For example, financing of assets, cleaning and maintenance contracts, municipal services, employee contracts, fixed contracts with corporate entities or tour operators for the provision of accommodation, advance bookings, etc.

Alternatively, if Ms S is unable to demonstrate her intention to carry on an enterprise at the outset, she must first make supplies of accommodation together with domestic goods and services in excess of R60 000 before applying for voluntary registration.

Excluded from the definition of “*enterprise*” is any activity that involves the making of exempt supplies or other supplies falling outside the scope of VAT.<sup>13</sup> If a person only makes exempt supplies or other non-taxable supplies, that person will not be able to register for VAT. In a case where the person is registered for VAT in respect of a taxable activity and also conducts non-taxable or exempt activities, VAT cannot be charged on the non-taxable or exempt supplies and input tax can only be claimed to the extent that taxable supplies are made.

For example, the following supplies constitute exempt supplies or other non-taxable activities:

- The supply of accommodation in a dwelling.
- The supply of accommodation which does not meet the requirements of the definition of “commercial accommodation” (under the minimum threshold of R60 000).
- The supply of accommodation in a hostel by an employer to employees, their families or other persons residing there, if –
  - the accommodation is used wholly or mainly to accommodate employees; and
  - the accommodation is subsidised or otherwise operated on a not-for-profit basis by the employer.
- The supply of other entertainment such as meals and beverages where the supplier does not cover the direct and indirect costs of making those supplies.
- Supplies made by public authorities<sup>14</sup> which have not been notified to register for VAT by the Minister.

<sup>13</sup> Refer also to **paragraph 2.9** where the term “*exempt supply*” is discussed.

<sup>14</sup> It should be noted that public schools are regarded as components of the Department of Education. As the Department of Education is a public authority, supplies (including supplies of entertainment) made by public schools are not taxable supplies.



**Example 2 – Exempt accommodation***Scenario*

Mining Company G has six hostels in which 50 migrant workers (employees) reside for 11 months of the year whilst they are away from their families and permanent homes in other parts of the country, or in other countries. During the December month, or at other times when the migrant workers are not occupying their units, the accommodation is made available to other persons, including independent contractors working at the mine. Accommodation is provided free of charge to employees, but a nominal charge is made to cover costs when other persons stay in the units.

*Question*

Does Mining Company G carrying on an enterprise in respect of the hostel accommodation provided to employees and other persons?

*Answer*

Mining Company G is an enterprise in respect of the mining activity, but it does not carry on an enterprise to the extent that it supplies lodging or board and lodging in the hostels as the supply of this type of accommodation is exempt in terms of section 12(c)(ii) of the VAT Act. Mining Company G must therefore not charge VAT to any of the occupants and it may not claim input tax on any expenses to provide the lodging or board and lodging, or any other expenses such as building maintenance, water, electricity, meals etc. Expenses which are not directly incurred in relation to the hostel accommodation, but which are also incurred for the mining activity must be apportioned (subject to the *de minimus* rule for apportionment).<sup>15</sup>

**2.8 ENTERTAINMENT**

This term includes the supply of food, beverages, accommodation, entertainment, amusement, recreation or hospitality. These terms are not further defined in the VAT Act, and therefore take their ordinary meaning. Examples are the sale of groceries and food, the provision of a meal in a restaurant, the provision of accommodation in a hotel, or entrance to a theatre or cinema.

**2.9 SUPPLY**

Refer to the **Glossary** for the definition of “supply” which includes a sale, donation or barter transaction. For the purpose of this guide, it is necessary to distinguish between a “taxable supply” and an “exempt supply”.

The term “taxable supply” is any supply made by a vendor in the course or furtherance of an enterprise on which VAT should be levied, and includes supplies which are subject to VAT at the zero rate.

The term also includes deemed supplies which are dealt with under specific provisions of the VAT Act, for example –

- the receipt of a grant from the State or a municipality for the purposes of making taxable supplies;
- the receipt of an indemnity payment under a contract of insurance; and
- the placing of a bet.

Exempt supplies are not taxable supplies and therefore no input tax can be claimed on any expenses incurred to make exempt supplies. In addition, output tax may not be levied thereon. The value of exempt supplies does not form part of the taxable turnover and therefore is not used in determining whether a person must register for VAT or not.

<sup>15</sup> Refer to proviso (iii) to section 17(1), or Chapter 7 of the VAT 404 Guide for Vendors.

If a person makes only exempt supplies, that person cannot register as a vendor. If the person is registered for VAT, the VAT incurred on any expenses incurred in order to make exempt supplies may not be claimed as input tax.

Examples of exempt supplies include–

- financial services (e.g. interest on a loan; a life insurance policy and membership of a medical scheme, provident fund, pension fund or retirement annuity fund);
- donated goods or services sold by associations not for gain (e.g. the sale of donated goods or services by religious and welfare organisations at fundraising events);
- renting of a dwelling for use as a private home (not being commercial accommodation);
- passenger transport within South Africa by taxi, bus or train;
- educational services (primary and secondary schools, universities, universities of technology (previous technikons) and other recognised institutions which qualify as public benefit organisations in terms of the Income Tax Act, 1962); and
- childcare services provided by crèches and after-school care centres.

*Refer also to the examples in **paragraph 2.7** in regard to other non-taxable supplies of accommodation and entertainment.*

## 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

In order to correctly apply the VAT legislation to the concept of “agents”, it is necessary to identify and understand the concept of an “agent” as understood in common law.

An agency is a contract whereby 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 “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 expressly construed 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 person who seeks to bind the principal and demonstrate that the relationship was that of a principal and agent. An understanding of the relationship between the parties is therefore a requirement in understanding the VAT treatment of supplies made by the parties.

The differences between an agent and a principal can be summarised as follows:

Agent	Principal
The agent will not be the owner of any goods or services acquired on behalf of the principal.	The principal is the owner of the goods or services acquired on the principal’s behalf by the agent.
The agent will not alter the nature or value of the supplies made between the principal and third parties.	The principal may alter the nature or value of the supplies made between the principal and third parties.
Transactions on behalf of the principal do not affect the agent’s turnover, except to the extent of the commission or fee earned on such transactions.	The total sales represent the principal’s turnover. The commission or fee charged by the agent forms part of the principal’s expenses.
An agent only declares the commission or fee for Income Tax and VAT purposes.	The principal declares gross sales as income for Income Tax and VAT purposes, and may be allowed to claim a deduction for the commission or fee charged by the agent.

In essence, the differences indicate that the principal is ultimately responsible for the commercial risks associated with a transaction, and that the agent concludes transactions 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.

In order to correctly apply the VAT legislation, it is necessary to identify and understand the contractual relationship between the parties. The VAT treatment of supplies proceeds from the fact of whether a person is acting on their 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 supplies are made to, or acquired by the principal (as the case may be). There are also special provisions which deal with the receipt and issuing of tax invoices. (*Refer to **paragraph 3.3** below.*)

As an agent merely acts on behalf of the principal, any output tax and input tax in relation to the underlying supplies made or received on behalf of the principal must be accounted for on the VAT return of the principal (if the principal is a vendor). The agent will only declare output tax and input tax in relation to the agency services supplied (if the agent is a vendor).

### **3.3 TAX INVOICES, CREDIT NOTES AND DEBIT NOTES**

The normal rule is that any tax invoice, credit note 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 this case, the agent's details may be reflected on the tax invoice, credit note or debit note and 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 note or debit note as if the supply is made to the agent.

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

In addition, the agent must, for supplies made on or after 1 January 2000, notify its principal each month in writing of –

- a description of the goods supplied;
- the quantity or volume of the goods supplied; and
- either –
  - the value of the supply, the amount of tax charged and the consideration for that supply; or
  - the consideration for the supply (if the amount of tax charged is calculated by applying the tax fraction to the consideration), and either the amount of tax charged, or a statement that the amount includes the tax and the rate at which the tax was charged.

In these circumstances, the agent is required to retain the original tax invoices, credit notes or debit notes (if these documents are to be retained on the principal's behalf) and sufficient records should be maintained to enable the name, address and VAT registration number of the principal to be ascertained.

### 3.4 APPLICATION OF AGENCY PRINCIPLES

According to the general principles of VAT –

- a supply of goods or services made **by** an agent on behalf of, or for the principal, is deemed to be a supply made **by** the principal; and
- a supply of goods or services **to** an agent on behalf of, or for the principal, is deemed to be a supply made **to** the principal.

In other words, the VAT consequences of the transaction will depend upon the principal's VAT status and not the agent's. To illustrate this concept, the example of travel agents, tour operators and hotels in the booking and arranging of accommodation and other entertainment is discussed in this chapter.

A travel agent acts as an intermediary between the person conducting the accommodation enterprise (the supplier) and the guest (the recipient). Travel agents receive a commission from accommodation establishments for the arranging service which they supply to the contracting parties. The travel agent's fees or commission earned in this regard is subject to VAT at the standard rate where service is rendered to a principal that is a vendor in South Africa. Any commission earned for booking travel and accommodation outside of South Africa is subject to VAT at the rate of zero per cent.

However, it should be noted that the use of the term “agent” or “agency” in the trading name or legal name of an enterprise, is not confirmation that the person conducting that enterprise is the legal agent of another person.

A primary factor in determining whether that person contracts as a principal or agent, is to establish whether the entertainment goods or services are contractually acquired –

- from the supplier of the entertainment, and then **on-supplied** at a marked-up price to the recipient (*refer to **Example 5***); or
- by the recipient from the supplier of the entertainment, and a commission or fee is paid to the person who acts as an intermediary (agent) for **arranging** the supplies (*refer to **Example 3** below*).

#### Example 3 – Agency principles (travel agent)

##### *Scenario*

Mr Guest wishes to go on holiday to Cape Town for two days. He makes a booking for accommodation with Hotel X through Travel Agent Y. Both Hotel X and Travel Agent Y are registered VAT vendors. Hotel X submits an invoice for R1 000 plus R140 VAT in respect of Mr Guest's stay to Travel Agent Y. Travel Agent Y recovers the full amount from Mr Guest and settles with Hotel X, net of any commission earned for arranging the booking. Travel Agent Y is entitled to a commission of 7% of the total charge to Mr Guest.

##### *Question*

What are the VAT implications of the transactions and how will the parties account for VAT?

*Continued overleaf ...*

**Example 3 (continued)***Answer**Travel Agent Y (legal agent – intermediary between Hotel X and Mr Guest)*

	R	R
Accommodation per Invoice No. 101		1 140.00
Less: Agent's, commission (7% of R1 000)	70.00	
VAT @ 14%	<u>9.80</u>	<u>( 79.80)</u>
Amount per enclosed cheque		<b><u>1 060.20</u></b>

Travel Agent Y will therefore account for output tax on R9.80 on the VAT 201 return for the period.

*Hotel X (principal – supplier of accommodation to Mr Guest)*

Output Tax	(R1 140 x 14/114)	140.00
Less: Input Tax		<u>9.80</u>
Amount payable to SARS		<b><u>130.20</u></b>

*Implications for the Mr Guest (recipient)*

Since Mr Guest's stay was a private expense (holiday), no input tax can be claimed. However, if Mr Guest (or his employer) is a vendor and the expense was incurred by the employer as personal subsistence for Mr Guest whilst away on business from his normal place of work and residence for at least one night, the employer may be able to claim input tax on the expense. (Refer to proviso (ii) to section 17(2)(a) and **paragraph 4.3.3.**)

**Example 4 – Agency principles (disbursements)***Scenario*

Whilst staying at Hotel X as set out in **Example 3**, Mr Guest notices an advert by Marlin Day Trips in the hotel reception area, advertising a deep sea fishing trip for R570 (including VAT). Mr Guest asks the receptionist at Hotel X to book him on a fishing trip for the next day, and to add the cost to his hotel bill. The arrangement between Hotel X and Marlin Day Trips is that a fee of R114 (including VAT) is paid for each client referred.

*Implications for Hotel X (legal agent – intermediary between Marlin Day Trips and Mr Guest)*

The hotel acts as agent in regard to the supply of the fishing trip. Therefore, if the R114 is to be reflected on the bill for accommodation presented by Hotel X to Mr Guest, the amount should be reflected as a separate disbursement and not as consideration for a taxable supply by Hotel X. The hotel will collect the R570 from Mr Guest and pay it over to Marlin Day Trips after deducting the referral fee of R114. Hotel X will therefore pay output tax of R14 (R114 x 14/114) on the referral fee, in addition to the R140 declared in respect of the accommodation as set out in **Example 3**. Marlin Day Trips will declare output tax of R70 on the receipt of R570 and will claim input tax of R14 on the referral fee paid to Hotel X.

*Implications for Mr Guest (recipient)*

As with **Example 3**, neither Mr Guest nor his employer may claim input tax on the fishing trip as the expense is of a private nature, and is not incurred in the course of conducting an enterprise.

**Example 5 – Tour operator acting as principal***Scenario*

Tour Operator Z enters into a contract with Hotel X, whereby the accommodation and associated domestic goods and services are acquired for R399 per night including VAT. Both Hotel X and Tour Operator Z are registered VAT vendors. Mr Guest makes a booking for accommodation with Tour Operator Z for a two-day holiday in Cape Town, where he will stay at Hotel X. Hotel X provides Tour Operator Z with a tax invoice for R798 including VAT and Tour Operator Z provides Mr Guest with an invoice for R1 000 plus R140 VAT for the accommodation and associated domestic goods and services. Mr Guest also receives an invoice for R228 (including VAT) from Hotel X for meals and beverages ordered from room service, and for telephone calls made during his stay at the hotel.

*Question*

What are the VAT implications of the transactions and how will the parties account for VAT?

*Answer*

*Hotel X (principal – supplies to Tour Operator Z and to Mr Guest)*

<u>Supply to Tour Operator Z – Invoice No. 211</u>		<u>Supply to Mr Guest – Invoice No. 219</u>	
	R		R
2 x night's accommodation (@ R350 per night)	700.00	Room service (meals and drinks)	150.00
VAT @ 14%	<u>98.00</u>	Telephone	50.00
Total	<b><u>798.00</u></b>	VAT @14%	<u>28.00</u>
			<b><u>228.00</u></b>

Hotel X will therefore account for output tax of R126 (R98 + R28) on the VAT 201 return for the period.

*Tour operator Z (principal – supply to Mr Guest)*

	R
Invoice No. 0034	
2 x night's accommodation (@ R500 per night)	1 000.00
VAT @ 14%	<u>140.00</u>
Total	<b><u>1 140.00</u></b>

**VAT calculation**

	R
Output tax	140.00
Input tax	<u>(98.00)</u>
	<b><u>42.00</u></b>

Travel Agent Y will therefore account for and pay a net amount R42 VAT for the period.

*For a detailed analysis of the VAT treatment of tour operators refer to Interpretation Note No. 42 – (2 April 2007) – The supply of goods and/or services by the travel and tourism industry.*

## CHAPTER 4

### GENERAL RULES ON ENTERTAINMENT

#### 4.1 INTRODUCTION

The provision of entertainment embraces an extremely wide ambit of supplies of both goods and services. In this chapter, the general rules which apply to persons who are in the business of providing entertainment are discussed. The special rules which apply to determine if a vendor will be able to claim input tax on entertainment expenses are also explained (whether that vendor is in the business of supplying entertainment or not).

Vendors such as welfare organisations which provide entertainment for no charge or for a charge which is not intended to cover the full cost of providing the entertainment are briefly mentioned. *(For more details in this regard, refer to the VAT 414 Guide for Associations not for Gain and Welfare Organisations.)*

#### 4.2 GENERAL RULE: DISALLOWANCE OF INPUT TAX

The general rule with regard to entertainment expenses and input tax, is that under section 17(2)(a), a vendor is not entitled to a deduction of input tax against output tax where goods or services are acquired by a vendor for the purposes of providing entertainment.

The provision reads as follows:

**17 Permissible deductions in respect of input tax**

(1) ...

(2) *Notwithstanding anything in this Act to the contrary, a vendor shall not be entitled to deduct from the sum of the amounts of output tax and refunds contemplated in section 16(3), any amount of input tax-*

(a) *in respect of goods or services acquired by such vendor to the extent that such goods or services are acquired for the purposes of entertainment: Provided that...*

The purpose of this general rule is to deny input tax for vendors who are not normally in the business of supplying entertainment in the ordinary course of conducting an enterprise. Common examples of entertainment expenses which will usually be denied under this general rule are as follows:

- Food and other ingredients purchased in order to provide meals to staff, clients and business associates. This includes year-end lunches and parties, hiring of venues for those functions, as well as expenses incurred for the provision of complimentary staff refreshments (e.g. tea, coffee and other beverages or snacks provided to staff).
- Business lunches, golf days, or other entertainment of customers and clients in restaurants, theatres, night clubs or sporting events.
- Goods and services acquired for providing employees with subsidised or free meals and beverages at workplace canteens if the direct and indirect costs of providing those benefits and facilities are not covered by the price charged (e.g. catering services, furniture, equipment and utensils used in kitchens, canteens and dining rooms).
- Beverages, meals, entertainment shows, amusements or other hospitality supplied to customers and clients at product launches and promotional events.
- Capital goods such as hospitality boxes, holiday houses, yachts and private aircraft which are used for entertainment.



## 4.3 EXCEPTIONS TO THE GENERAL DISALLOWANCE RULE

### 4.3.1 Introduction

The general rule that the VAT incurred on entertainment expenditure may not be claimed as input tax is subject to a number of exceptions. This is evident from the wording of section 17(2)(a) which has been highlighted below in bold font:

- (2) Notwithstanding anything in this Act to the contrary, a vendor, shall not be entitled to deduct from the sum of the amounts of output tax and refunds contemplated in section 16(3), any amount of input tax-*
- (a) in respect of goods or services acquired by such vendor to the extent that such goods or services are acquired for the purposes of entertainment: **Provided that this paragraph shall not apply where-***

Provisos (i) to (ix) of section 17(2)(a) list the specific circumstances under which input tax may be claimed. These exceptions are explained in **paragraphs 4.3.2 to 4.3.10** below.

### 4.3.2 Businesses supplying entertainment

#### 4.3.2.1 General principles

The wording of proviso (i) to section 17(2)(a) is as follows:

- (2)...
- (a) ...
- (i) *such goods or services are acquired by the vendor for making taxable supplies of entertainment in the ordinary course of an enterprise which-*
- (aa) continuously or regularly supplies entertainment to clients or customers (other than in the circumstances contemplated in item (bb)) for a consideration to the extent that such taxable supplies of entertainment are made for a charge which-*
- (A) covers all direct and indirect costs of such entertainment; or*
- (B) is equal to the open market value of such supply of entertainment,*
- unless-*
- (i) such costs or open market value is for bona fide promotion purposes not charged by the vendor in respect of the supply to recipients who are clients or customers in the ordinary course of the enterprise, of entertainment which is in all respects similar to the entertainment continuously or regularly supplied to clients or customers for consideration; or*
- (ii) the goods or services were acquired by the vendor for purposes of making taxable supplies to such clients or customers of entertainment which consists of the provision of any food and a supply of any portion of such food is subsequently made to any employee of the vendor or to any welfare organization as all such food was not consumed in the course of making such taxable supplies;*
- (bb) supplies entertainment to any employee or office holder of the vendor or any connected person in relation to the vendor, to the extent that such taxable supplies of entertainment are made for a charge which covers all direct and indirect costs of such entertainment;*

Proviso (i) to section 17(2)(a) is split into two main parts, (aa) and (bb), which set out the main exception to the general disallowance rule. This provision allows vendors that are in the business of supplying entertainment for a consideration in the ordinary course of an enterprise to claim input tax on purchases of entertainment goods or services.

The definition of “*enterprise*” as discussed in **Chapter 2** does not impose any requirement as to how a business must be conducted, or that it must operate at a profit before it may deduct the VAT incurred on certain expenses as input tax. However, as discussed in **Chapter 1**, special rules apply for businesses that supply entertainment because of the potential abuse in regard to entertainment expenses being deducted as input tax, when they have actually been incurred for private purposes. Proviso (i) above is the main exception to the general rule that input tax may not be claimed on entertainment expenses.

The rule allows businesses that make taxable supplies of entertainment to deduct input tax if, during the normal course of the day-to-day activities of the entertainment business, entertainment is continuously or regularly supplied for a consideration, which is sufficient to cover the direct and indirect costs of making the supplies. This refers to a vendor whose business involves the supply of entertainment on an on-going commercial basis, and does not refer to supplies of entertainment which have the purpose of promoting other types of supplies which are not in the nature of “*entertainment*”.

Essentially, what this provision does is to introduce an anti-abuse rule in the form of *bona fide*<sup>16</sup> business test for enterprises that supply entertainment. Since the rule is structured so that input tax will only be allowed to the extent that taxable supplies of entertainment are made for a charge which covers all the direct and indirect costs,<sup>17</sup> it can be concluded that the type of businesses contemplated here, are ones that pursue a profit motive. Having a profit motive means that the business has an intention of pursuing a business activity (in this case the supply of entertainment) where there is a reasonable chance of generating a surplus of revenue over all costs of operating that business.

In other words, the VAT law is drafted so that where *bona fide* entertainment expenditure has been incurred for enterprise purposes, and these can be connected to the type of entertainment supplies made, the input tax should, in principle, be allowed. The idea is to exclude claims for input tax which are in relation to personal use or enjoyment of the entertainment supplied by the vendor's business, or where abusive practices are employed to provide some benefit to the vendor supplying the entertainment, or to the vendor's employees, or to a connected person in relation to the vendor.

#### 4.3.2.2 Supplies to customers and clients

Proviso (i) to section 17(2)(a) is structured so that part (aa) deals with the rules for businesses which supply entertainment to customers and clients, and part (bb) deals with supplies made to employees and connected persons. (Refer to **paragraph 4.3.2.3** for a discussion on part (bb) of proviso (i).) The main points regarding the supply of entertainment to customers and clients are highlighted in paragraphs (a) to (c) below.

(a) *The goods or services acquired must be in the ordinary course of an enterprise which continuously or regularly supplies entertainment*

To meet this requirement, the vendor must supply entertainment of a type which has a close association with the type of purchases on which the vendor seeks to claim input tax. In other words, there must be a clear link between the type of goods or services acquired, and the type of entertainment supplied by that vendor. A further point is that the specific kind of entertainment must be supplied in the ordinary course of conducting that enterprise, and not as an *ad hoc* or intermittent activity.

For example, consider a restaurant business. From a commercial point of view, a *bona fide* restaurant business will take into account the cost of all inputs when determining its final menu prices including the supply of ice and condiments and other entertainment goods or services supplied as an integral part of the meal, or as part of the dining experience as a whole. Therefore, the restaurant business in this example would, in principle, meet the requirements for the deduction of input tax on its VAT inclusive entertainment expenses if –

- the entertainment is supplied in the ordinary course of conducting the restaurant enterprise;
- the restaurant is a *bona fide* business operating on a continuous or regular basis; and
- the vendor has a genuine intention to cover all the direct and indirect costs of providing the entertainment based on the prices charged.

<sup>16</sup> According to the Encarta Dictionary: English (UK), the term “*bona fide*” means “*authentic and genuine in nature*” and “*without any intention to deceive*”.

<sup>17</sup> The law refers to a charge which covers all the direct and indirect costs of supplying the entertainment **or** which is equal to the open market value of the supply. For example, when perishable goods approach their expiry date, the commercial reality for the enterprise is that the goods might have to be sold at less than cost to at least reduce any loss on those items. In such cases, the selling price is regarded as the open market value.

**Example 6 – Clear link between the type of purchases and the entertainment supplied***Scenario*

Restaurant M (a vendor) acquires the following goods and services:

- Alcoholic drinks such as beer, wine and spirits.
- Food and ingredients such as raw meat and vegetables.
- Condiments such as cooking oil, olive oil, balsamic vinegar, ice, sauces and spices which are either used in the cooking process, and/or are placed on tables for consumption by customers.
- Wood and charcoal for the dining room fireplace and the pizza oven.
- Dining furniture, kitchen equipment, cooking and dining utensils.

*Question*

May Restaurant M claim input tax on the goods and services acquired for supplying entertainment?

*Answer*

There is no reason why the VAT incurred on all the goods and services acquired should not be allowed as input tax in this case if it is evident that –

- there is a clear link between the kind of goods or services acquired, and the type of entertainment supplied by Restaurant M; and
- Restaurant M is in the business of supplying entertainment in the ordinary course of conducting the enterprise (i.e. supplying hospitality in the form a dining experience where cooked meals, and chilled beverages are served to customers); and
- Restaurant M is a genuine business which has a profit motive and will, wherever possible, charge a price (consideration) for meals and beverages which is intended to cover all the direct and indirect business costs of supplying the entertainment.

**Note**

Where goods or services are acquired at the zero rate (e.g. the raw vegetables and vegetable cooking oils), no input tax may be claimed, as no VAT would have been incurred.

*(b) The entertainment must be supplied for a consideration which covers the costs*

This requirement has two aspects, namely –

- the entertainment must be supplied for a consideration; and
- the consideration (price charged) must at least cover all the direct and indirect costs of making that supply of entertainment, or at least be equal to the open market value thereof.<sup>18</sup>

Whether an expense is regarded as direct or indirect depends on the extent to which costs can be directly attributed (allocated) to the entertainment activities concerned. Therefore, direct costs are directly attributed to a specific cost objective and indirect costs are those elements, which could be associated with more than one cost objective.

Where it is not possible in the ordinary course of the enterprise for the supply to be made for a consideration which covers all the direct and indirect costs, the supply must be made for a charge which is at least equal to the open market value thereof. For example, where a supermarket supplies perishable stock at a special promotion price in order to dispose of the stock before its expiry date, the input tax on the acquisition of those items will not be denied, as the promotional price (less than the normal selling price), may be regarded as the open market value in the circumstances.

<sup>18</sup> Refer to **footnote 17**. The need to consider the open market value will only apply in limited cases. For the purposes of this guide, unless it is necessary to consider the open market value in the specific circumstances, the discussion on the application of proviso (i) to section 17(2)(a) will focus mainly on the requirement that the supply should be made for a consideration that covers all the direct and indirect costs.

**Example 7 – Covering the direct and indirect costs***Scenario*

Manufacturer T (vendor) manufactures motor cars and has a canteen facility on its premises where prepared meals and beverages are served to staff. Other information is as follows:

- The canteen has six full time staff, and every day two of the factory workers assist for half of a working day in the canteen.
- Prices are set so that the costs of running the canteen plus 5% is recovered from customers.
- The factory premises are rented but no separate rental is paid for the canteen area, which constitutes 7% of the total space of the factory.
- No separate bills for water and electricity are received, but there is a dedicated telephone in the canteen area used exclusively by the canteen staff and for which a separate bill is received.
- Manufacturer T purchased fridges, ovens, dining furniture and kitchen equipment which are used exclusively in the canteen. Manufacturer T also entered into a single contract with another vendor to maintain 12 appliances, nine of which are situated in the canteen, and three in the office area.

*Question*

Which are the direct and indirect expenses attributable to the canteen facility?

*Answer**Direct expenses*

- Salaries of six full time staff
- Dedicated canteen telephone
- Stock purchases of food and beverages for resale to customers
- A monthly allocation in respect of capital purchases of appliances and equipment used exclusively in the canteen. (Fridges, ovens, dining furniture, kitchen equipment etc.)<sup>19</sup>

*Indirect expenses*

- Part of the salary of two part-time employees (say 50%)
- Water, electricity and rent (say 7% of each)
- Appliance maintenance contract costs (say 9/12 or 75%).

If Manufacturer T wants to claim input tax on the canteen (entertainment) expenses, it must ensure that the above costs are incorporated into, and covered by, the income generated through the use of its pricing model of “costs” plus 5%.

*(c) Supplies for no consideration*

The VAT law permits input tax to be claimed on entertainment purchases if a vendor supplies entertainment for no consideration to clients or customers in the following three instances:

- Where entertainment is supplied as part of a *bona fide* promotion if that supply is similar in all respects to the entertainment normally supplied by that vendor. For example, where, as part of a special offer, two of the same products are supplied for the price of one.
- Where the entertainment consists of the supply of food in a situation where not all the food was consumed. The rule is that where the excess food is provided to employees, or donated to a welfare organisation, the VAT incurred by that vendor on the food which was not consumed by the recipient during the occasion will be allowed as input tax.
- Where the entertainment consists of meals and beverages supplied as subsistence by the employer to employees in certain situations. Refer to **paragraphs 4.3.3 and 4.3.9** for examples.

<sup>19</sup> The amount of the monthly allocation of costs for the capital items will depend on the costing methodology used by the enterprise. For example, the cost could be amortized over the lifetime of the asset concerned.

**Example 8 – Promotional gifts***Scenario*

DVD Rentals is a vendor which rents DVDs to the general public. At the end of every year, it supplies its top 10 clients with a gift consisting of a bottle of wine and a box of chocolates.

*Question*

May DVD Rentals claim input tax on the acquisition of the wine and chocolates?

*Answer*

No, DVD Rentals will fail the test for claiming input tax for the following reasons:

- Although DVD Rentals might regard the expense as a genuine promotional expense, the business does not supply wine and chocolates in the ordinary course of its enterprise; and
- The wine and chocolates are supplies of entertainment for no consideration.

**Example 9 – *Bona fide* promotions***Scenario*

Candy Dreams is a business which supplies ice cream and milkshakes to clients. Candy Dreams opens a new store in a major shopping centre where it has a “buy-one-get-one-free” promotion every Saturday for two months after the opening date.

*Question*

May Candy Dreams claim input tax on the promotional items supplied?

*Answer*

Yes, input tax may be claimed on the promotional items supplied. This is because the ice creams and milkshakes are supplied as part of a *bona fide* promotion and constitute the same kind of entertainment normally supplied by Candy Dreams in the ordinary course of its enterprise.

**Example 10 – Free snacks and beverages provided by casinos***Scenario*

Wild Fling Casino is a business which supplies a variety of entertainment to its clientèle, including gambling, gaming, amusement, theatrical performances, accommodation, and food and beverages provided through various bars and restaurant facilities. Within the casino establishment, free snacks and beverages are supplied to customers whilst they are gambling at the tables or slot machines.

*Question*

May Wild Fling Casino claim input tax on the free snacks and beverages provided to customers?

*Answer*

If the casino operates a hotel or restaurant, or provides similar entertainment as part of its enterprise, it may deduct input tax on any food and beverages supplied to customers free of charge. The reason is that the supplies are regarded as being part of a *bona fide* promotion of its supplies of entertainment. However, where for example, the casino provides customers with complimentary vouchers for meals or accommodation, which entertainment is supplied by another vendor operating on the casino premises, or at another location, the casino business may not deduct the VAT incurred on acquiring those vouchers.

*For more details on gambling, refer to Interpretation Note No. 41 – Application of VAT to the gambling industry.*

### 4.3.2.3 Supplies to employees and connected persons

Whereas part (aa) of proviso (i) to section 17(2)(a) sets out the rules for supplies of entertainment made to customers and clients, part (bb) focuses on a situation where entertainment is supplied by a vendor to any employee or office holder of the vendor, or any connected person in relation to the vendor. A typical situation envisaged here, is where an employer provides its staff with meals through a canteen facility operated by that employer.

The general rules for claiming input tax in this situation are much the same as those explained in **paragraphs 4.3.2.1 and 4.3.2.2** above. For example, the vendor must ensure that the direct and indirect costs of operating the canteen are covered before input tax will be allowed. However, the main difference is that part (bb) of the proviso, does not provide for any exceptions that allow input tax to be claimed when supplies of entertainment are made to employees or connected persons for no consideration, or for a consideration which does not cover all the direct and indirect costs.

Part (bb) of the proviso therefore recognises that where a vendor supplies entertainment to employees or connected persons in relation to the vendor, the risk of personal consumption or abusive practices is much greater and therefore the law provides for less flexibility in accommodating exceptions to the rule. (Refer to **Chapter 8** for more details in regard to the outsourcing and management of catering services.)

### 4.3.3 Personal subsistence

The wording of proviso (ii) to section 17(2)(a) is as follows:

- (ii) *such goods or services are acquired by the vendor for the consumption or enjoyment by that vendor (including, where the vendor is a partnership, a member of such partnership), an employee, office holder of such vendor, or a self-employed natural person in respect of a meal, refreshment or accommodation, in respect of any night that such vendor or member is by reason of the vendor's enterprise or, in the case of such employee, office holder or self-employed natural person, he or she is by reason of the duties of his or her employment, office or contractual relationship, obliged to spend away from his or her usual place of residence and from his or her usual working-place. For the purposes of this section, the term 'self-employed natural person' shall mean a person to whom an amount is paid or is payable in the course of any trade carried on by him or her independently of the person by whom such amount is paid or payable and of the person to whom the services have been or are to be rendered, as contemplated in the proviso to paragraph (ii) of the exclusions to the definition of 'remuneration' in paragraph 1 of the Fourth Schedule to the Income Tax Act;*

Proviso (ii) to section 17(2)(a) provides for a situation where employees incur personal subsistence expenditure on behalf of the employer in connection with their employment. If the actual expenditure is reimbursed to the employee, or if it is borne directly by the employer, input tax may be claimed on expenditure such as hotel accommodation and meals provided to the employee whilst away on business for the employer. With effect from 7 February 2007 an amendment to the VAT Act extended this provision to include personal subsistence expenses in respect of certain self-employed natural persons who are appointed to provide services. An example is when a vendor who is involved in direct sales appoints an independent self-employed natural person (which person is not an “employee” of the vendor) to act on that vendor’s behalf to conclude sale agreements with customers at various locations around the country.

The provision is limited in its application to instances where the personal subsistence is in respect of certain specified persons as follows:

- The vendor (e.g. sole proprietor or member of a partnership), or in the case of a vendor which is a juristic person, the official representative of the vendor (e.g. member of a close corporation, director of a company etc).
- An employee or office holder of the vendor.
- In certain instances, a self-employed natural person.

If the consumption or enjoyment of the meal, refreshment or accommodation is in respect of a spouse travelling with any of the above specified persons, or where clients are entertained in a restaurant whilst negotiating a business deal, the VAT incurred on these expenses will not qualify for a deduction of input tax. Also, where an allowance is paid to an employee to cover such expenses as a part of that person's remuneration, no input tax credit will be allowed to the employer.

The following conditions must also be met:

- The person must spend at least a night away from their usual place of residence and usual working-place.
- The person must, by reason of the prescribed duties of employment, office or contractual relationship, be on a business trip for the purpose of conducting taxable supplies on behalf of the vendor.
- If the vendor engages a self-employed natural person (independent contractor) to conduct business at a place which is away from that person's usual place of residence and usual working-place, it must be evident from the contractual obligations that the vendor on whose behalf the business is conducted is the person who is liable for the subsistence expenses.

It is recommended that the tax invoices be issued in the name of the employer, to eliminate any doubt as to whether the personal subsistence expenditure is a private expense of the employee or a legitimate business expense incurred on behalf of the employer.

#### **Example 11 – Usual working-place**

##### *Scenario*

A photographer (vendor) who lives in Pretoria carries out photographic sessions at various locations around the country and internationally. She has an office in Johannesburg where she has three staff who answer the phones, develop pictures, and take care of administrative and customer service related matters. She also has a home office from where she carries out certain work from time-to-time. No employees work at the home office.

##### *Question*

Where is the photographer's usual working-place located?

##### *Answer*

Although the photographer has an office situated at her home (place of residence), this is not regarded as the usual working-place. The usual working-place is the registered physical address of the office in Johannesburg from where the activities of the business are carried out on a day-to-day basis.

The usual place of residence of a person is fairly easy to establish in most cases. However, where there is doubt, the view as set out in Income Tax Interpretation Note No. 3 (dated 4 February 2002) on the subject of the definition of "*resident*" in relation to a natural person as well as the relevant case law will be applied to determine the place where that person is "ordinarily resident".

When a person carries out work consistently at a single location such as a factory or office, the "usual working-place" is fairly easy to establish. However, where the business has many offices, branches or divisions, or where the nature of the work is such that it is carried out at various temporary or remote locations, the question of where that person's usual working-place is located becomes more difficult to answer.

The view is that the "usual working-place" of an employee, is the fixed place of work, such as an office or factory from where the employer conducts the business and where the employee is based. This will usually also be the chosen *domicile* or registered physical address of the employer's business for the purpose of serving summons and facilitating service of process (*domicilium citandi et executandi*).

As a further guideline, this will also be the place to which the employee will typically return or visit from time-to-time –

- to attend official meetings with management, other employees or clients, or to participate in progress meetings in connection with the work carried out by the employee;
- to report for work or to management or supervisors before starting, or after completing a project/work assignment at a remote location in the field, or to receive further instructions;
- to embark on transportation provided by the employer from the place of work to the physical worksite;
- to apply for leave, collect a payslip, or deal with other administrative matters in connection with the contract of employment.

Where a foreign business conducts an enterprise in South Africa and is liable to register for VAT, the question of whether subsistence costs incurred may be claimed as input tax under this provision becomes more difficult, as it introduces additional complexities. For example, consider a foreign business located in a country in Europe which employs local (RSA) residents or self-employed natural persons (independent contractors) to carry out work on a salvage project in the RSA. The foreign business may also bring its own employees who are resident in the home country in Europe to the RSA for the purpose of carrying out that assignment, or the business may even engage the services of persons who are resident in a third country. The usual working-place and usual place of residence of each of the various groups of persons will have to be established if the employer has incurred VAT on subsistence costs for these workers which it wants to claim as input tax.

If the employees who come to RSA are ordinarily resident in a foreign country, there is no doubt that by reason of their duties, they will be required to spend at least a night away from their usual place of residence whilst working on the salvage project. The question is whether they also spend the nights away from their "usual working-place". Based on the discussion above, the physical salvage site where the wreck is situated is generally not considered to be the employees' "usual working-place" during the time they physically work on the project. The "usual working-place" for foreign resident employees in these cases will normally be the place of business of the employer which is located in the foreign country. For local (RSA) employees of a foreign business which carries on an enterprise in the RSA, the "usual working-place" will be the local physical address or place of business from where the RSA activities are carried out. Employees will usually not reside at the physical site where the salvage operation will take place. In any event, even if they did stay at these locations, the accommodation facilities provided on a salvage vessel or installation would not normally be regarded as the dwellings (usual residences) of the employees. The same will apply in regard to the hotels or guest houses where the employees will normally be accommodated during such work assignments. Further, even if the salvage vessel or installation is anchored or erected near the worksite, this would not normally be considered to be the "usual working-place" of the employees.

Therefore, the view is that the VAT incurred on overnight accommodation and related subsistence costs may normally be claimed as input tax by the employer where the nature of the work done by the enterprise requires the employees or the contracted workers (who are self-employed natural persons) to carry out work at remote or temporary locations in the field. This will apply whether the enterprise is carried on in the RSA permanently or temporarily and regardless of where the person conducting that enterprise is considered to be resident.

Caravans, pre-fabricated housing units, and other temporary structures erected on worksites are often used for a dual purpose, namely, as accommodation for employees, and to serve as a site office. An input tax deduction may be made by the vendor in respect of the provision of temporary accommodation to employees in a caravan or other temporary structure at a building site or other remote work location. However, the claiming of input tax on temporary accommodation and subsistence costs in this situation must be distinguished from the provision of employee housing as discussed in **paragraph 6.1.4** where no input tax may be deducted by the employer as it is an exempt supply in terms of section 12(c).



#### 4.3.4 Taxable transportation services

The wording of proviso (iii) to section 17(2)(a) is as follows:

- (iii) such goods or services consist of a meal or refreshment supplied by the vendor as operator of any conveyance to a passenger or crew member, in such conveyance during a journey, where such meal or refreshment is supplied as part of or in conjunction with the transport service supplied by the vendor, where the supply of such transport service is a taxable supply;*

Proviso (iii) to section 17(2)(a) allows vendors to claim input tax on the entertainment expenses incurred in order to provide meals, refreshments or other entertainment as an integral part of a taxable transportation service. The rationale underlying this provision is that a normal business which has a profit motive will have to factor the expenses incurred to provide the on-board entertainment into the price of the ticket so that all the direct and indirect costs of providing the entertainment will be covered. Examples include meals, beverages, film shows and other entertainment provided to travellers whilst being conveyed by the transport operator on board a ship or aircraft where that entertainment has been included in the fare which has been subject to VAT at the standard rate. Transportation of fare-paying passengers by road or rail would also fall within this provision to the extent that the supplier is a vendor, and the supply constitutes international transportation which is subject to VAT at the zero rate.

Where the road or railway transport is exempt from VAT, no input tax deduction may be made on the provision of meals or refreshments to passengers or crew. The value of the supply of any such meals or refreshments is deemed to be nil where the price of the meal is included in the price for the exempt transportation. Part of the abuse that this provision originally intended to prevent was the claiming of an input credit where entertainment was provided to crew in lieu of a salary. However, meals provided to cabin crew on board an aircraft, ship or other conveyance is not the abuse that the provision intended to target. The provision was therefore amended with effect from 22 December 2003 to allow input tax on meals and refreshments provided to crew on board the conveyance.

If any entertainment is supplied by the transport operator for a separate consideration on-board the vehicle which is transporting the passengers, or at any stopover, the supply will be subject to the normal VAT rules pertaining to the supply of entertainment as explained in **paragraphs 4.2, 4.3.1 and 4.3.2**. For example, snacks and beverages sold separately to travellers on local flights.

#### 4.3.5 Seminars or similar events

The wording of proviso (iv) to section 17(2)(a) is as follows:

- (iv) such goods or services consist of a meal or refreshment supplied by the vendor as organizer of a seminar or similar event to a participant in such seminar or similar event, the supply of such meal or refreshment is made during the course of or immediately before or after such seminar or similar event and a charge which covers the cost of such meal or refreshment is made by the vendor to the recipient;*

Proviso (iv) provides that the vendor as organiser of a seminar or similar event may claim input tax on purchases of goods or services which are in connection with the supply of meals or refreshments to participants at seminars and similar events. The kind of events envisaged here, are events which have the objective of transferring knowledge by the organisers of the event to the participants (or to the employers of the participants), through some element of instruction, study, training, teaching or coaching. The provision is very similar to proviso (iii) which is discussed in **paragraph 4.3.4** and has the same rationale. The principle is that input tax should be allowed where the entrance fee or other charge to participate in the event is sufficient to cover all the direct and indirect costs of providing the seminar or event, including any meals and/or refreshments which are supplied as an integral part of that event.

The meals or refreshments can be supplied to the participants before, during, or immediately after the event and the charge for the meal or refreshment may be included in the fee for the seminar, or charged separately.

### 4.3.6 Municipal recreational facilities

#### 4.3.6.1 Before 1 July 2006

The wording of proviso (v) to section 17(2)(a) before being amended was as follows:

- (v) such goods or services are acquired by a local authority for the purpose of providing sporting or recreational facilities or public amenities to the public in the circumstances referred to in section 8(6)(a) or for the purposes of the provision of the goods or services referred to in paragraph (c)(iv) of the definition of 'enterprise' in section 1.*

Before 1 July 2006, goods and services provided to the general public by a local authority (or municipality as it is now known) which were funded from municipal property rates income, were regarded as being "out of scope" for VAT purposes and did not form part of the local authority's enterprise. In effect, this meant that these supplies were treated similar to exempt supplies. Consequently, most local authorities could not claim any input tax on expenses incurred to provide public recreational facilities such as parks, gardens, children's playgrounds, sports fields and swimming pools, where no charges were made to cover the costs of providing and maintaining those facilities.

There are, however, three instances where a local authority was able to claim input tax on public recreational facilities before 1 July 2006. These are explained briefly in paragraphs (a) to (c) below:

- (a) If the local authority charged a flat rate consideration for rates and all other charges for goods and services supplied to property owners*

If a local authority charged a flat rate consideration (composite fee) for the supply of water, electricity, sewage, drainage and related services, as well as rates calculated on fixed property, it was required to levy VAT on the full amount charged.<sup>20</sup> However, as the supply of goods or services in such cases were subject to VAT, an input tax deduction was allowed to the local authority on all the VAT-inclusive costs incurred (including certain entertainment expenses) for the purpose of providing or maintaining those sporting or recreational facilities or public amenities. Although the application of this method is being phased out, there are still some municipalities which operate in this manner.

- (b) If the local authority was a Regional Service Council (RSC), a Joint Services Board (JSB) or Transitional Metropolitan Council (TMC) and the entertainment was funded from levies*

Before 1 July 2006 these entities were regarded as local authorities and were allowed to raise levies on businesses in their areas of jurisdiction. The JSB, RSC and TMC levies were subject to VAT at the standard rate before being abolished with effect from 1 July 2006 and were often used to fund capital projects such as the construction of sports fields, parks and gardens and other public amenities. In these cases, input tax was allowed to the extent that the JSB, RSC or TMC levies were sufficient to fund the VAT-inclusive expenses incurred for the purpose of provided the facilities.<sup>21</sup>

- (c) Enterprise activities listed in the category of businesses in Regulation 2570 dated 21 October 1991*

Local authorities that carried on certain entertainment activities listed in Regulation 2570 on the basis that the income was sufficient to cover all the costs of conducting that activity (including a reasonable provision for depreciation and any grant or subsidy received for conducting that business, but excluding capital expenditure), the activity was deemed to be a taxable activity, carried on in the course or furtherance of the local authority's enterprise. Any VAT incurred for the purposes of providing the entertainment at those facilities could be deducted as input tax in these circumstances.

<sup>20</sup> In terms section 8(6)(a) of the VAT Act, before that section was deleted.

<sup>21</sup> The unblocking of input tax under this provision does not override the normal rule as discussed under **paragraphs 4.3.1 and 4.3.2** for any other entertainment supplied. For example, no input tax may be claimed by the RSC, JSB or TMC if food and beverages are supplied at an entertainment event such as a concert or theatrical production where the direct and indirect costs of holding that event are not covered.

Examples include –

- caravan parks, pleasure and holiday resorts;
- hiking trails; and
- game farms.

#### **Example 12 – Public recreational facilities (RSC)**

##### *Scenario*

On 10 July 2004, a RSC incurs expenses (including VAT) to develop a public park which includes swimming pool amenities, a sports field, and playground amusements for the entertainment of children. The cost of providing the facilities was financed exclusively from RSC levies. The RSC charges an entrance fee to the general public for using the facilities.

##### *Question*

Will the RSC be able to claim input tax on the expenses incurred to provide the recreational facilities at the public park?

##### *Answer*

Yes, as all the facilities at the public park were financed by RSC levies, the RSC will be able to claim input tax on the expenses incurred to provide the entertainment facilities. The RSC must levy VAT on all fees charged for entrance to, or the use of, the facilities as well as any other charges for other goods or services supplied to customers.

#### **4.3.6.2 On or after 1 July 2006**

The wording of proviso (v) to section 17(2)(a) was amended to read as follows:

- (v) *such goods or services are acquired by a municipality for the purpose of providing sporting or recreational facilities or public amenities to the public;*

The effect of the amendment is that municipal property rates levied by a municipality upon a property owner became subject to VAT at the zero rate instead of being exempt. With effect from 1 July 2006 municipal property rates are viewed as charges in respect of taxable supplies made by the municipality to customers at the zero rate. This allows the municipality to claim input tax on VAT-inclusive expenses incurred to make those supplies, even where there might be no explicit or direct charge. It follows that a municipality may claim input tax on expenses incurred to provide public recreational facilities such as sports fields, parks and gardens and the maintenance of those facilities. As is the case before 1 July 2006, this provision does not override the general rules as discussed in **paragraphs 4.3.2 and 4.3.5** which requires that the direct and indirect costs of holding an entertainment event such as a concert or theatrical production must be covered before the municipality will be allowed to claim input tax thereon.

#### **Example 13 – Public recreational facilities (municipalities)**

##### *Scenario*

On 10 July 2008, ABC Municipality incurs expenses (including VAT) to develop a public park which includes amenities such a sports field, swings, slides and other playground facilities for the entertainment of children. The facilities are made available free of charge to the general public.

##### *Question*

Will ABC Municipality be able to claim input tax on the expenses incurred to provide the recreational facilities at the public park?

*Continued overleaf ...*

**Example 13 (continued)***Answer*

Yes, with effect from 1 July 2006, proviso (v) to section 17(2)(a) allows the municipality to claim 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 an explicit charge which covers all the direct and indirect costs of providing that entertainment.

**4.3.7 Welfare organisations**

The wording of proviso (vi) to section 17(2)(a) is as follows:

*(vi) such goods or services are acquired by a welfare organization, for the purpose of making supplies in the furtherance of its aims and objects; or*

A welfare organisation is any public benefit organisation (PBO) contemplated in paragraph (a) of the definition of “*public benefit organisation*” in section 30(1) of the Income Tax Act, No. 58 of 1962 that has been approved by the Commissioner in terms of section 30(3) of that Act, and which carries on a “*welfare activity*” as listed in Government Notice No. 112 of 11 February 2005 (GN 112).

Generally, vendors can only claim input tax in respect of entertainment expenses incurred if they supply that entertainment at a charge that covers both the direct and indirect costs thereof. However, proviso (vi) provides that a welfare organisation may claim input tax in respect of any entertainment expenses incurred for the purpose of conducting welfare activities in the furtherance of the organisation’s aims and objectives. A welfare organisation may therefore benefit from the VAT system in that it may register for VAT and claim input tax in regard to welfare activities which it carries on (including supplies of entertainment), even where no consideration is charged.

In order to qualify as a welfare organisation for VAT purposes and to take advantage of the benefits provided within the VAT system, the PBO must carry on any of the welfare activities listed in GN 112, under the following headings:

- Welfare and humanitarian.
- Health care.
- Land and housing.
- Education and development.
- Conservation, environment and animal welfare.

Although the list of welfare activities has as its source the Ninth Schedule to the Income Tax Act, the specific welfare activities identified for VAT purposes in GN 112 are a lot more restrictive than the Ninth Schedule. The main reason for this is that the list excludes activities that would generally be exempt for VAT purposes.

A welfare organisation may, for example, be entitled to input tax in respect of the following:

- The acquisition of food for supply to homeless children (Welfare and humanitarian activity).
- The provision of medicines, meals and accommodation in a clinic to poor and needy persons (Health care activity).

*For further information relating to PBOs and welfare organizations, refer to the VAT 414 Guide for Associations not for Gain and Welfare Organisations as well as the Tax Exemption Guide for Public Benefit Organisations in South Africa, both of which are available on the SARS website [www.sars.gov.za](http://www.sars.gov.za).*

#### 4.3.8 Medical care facilities

When proviso (vii) to section 17(2)(a) was originally introduced, the wording was as follows:

*(vii) such goods or services (where no consideration relating specifically to the supply of entertainment is payable shall be deemed to constitute a single supply for purposes of this subsection) are acquired by a vendor for an employee or office holder of such vendor, that are incidental to the admission into a medical care facility.*

Before the introduction of this provision, the issue was that if the employer incurred the expenses in connection with the hospitalisation of an employee, the VAT incurred on the medical fees could be claimed as input tax, but no input tax was allowed on any expenses in respect of any incidental entertainment provided in the form of meals and accommodation to the employee whilst recovering in the medical care facility. With effect from 22 December 2003, this proviso was introduced to extend the allowable input tax to include the incidental meals and accommodation provided in these circumstances. However, the wording of the provision at that time only allowed the employer to claim input tax on meals and accommodation where there was no separate and specific consideration attributable to the supply of entertainment by the medical care facility. In other words, where there was no separate charge for the meals and accommodation by the medical care facility, the entire charge was regarded as being in respect of a single supply of medical services and the employer could claim input tax on the entire charge. The implication being that where entertainment charges for meals and accommodation were indicated separately on the invoice from a hospital or other medical care facility, the VAT on those separate charges would not be allowed as input tax.

The wording was subsequently amended and currently reads as follows:

*(vii) such goods or services are acquired by a vendor for an employee or office holder of such vendor, that are incidental to the admission into a medical care facility;*

The amendment, which applies from 24 January 2005, removed the words “(where no consideration relating specifically to the supply of entertainment is payable shall be deemed to constitute a single supply for purposes of this subsection)”. The amended wording continues to regard the meals and accommodation supplied by the medical care facility as being “incidental” to the medical services, but ensures that employers are entitled to claim input tax on the payment of ward fees, meals and beverages for hospitalised employees, even where the items are separately reflected on the invoice.

Any hospitalisation services or entertainment provided by the employer to any employees who are injured on duty (whether provided at the employer’s medical facility or at a private facility) is regarded as a fringe benefit provided to the employee, but a nil value applies. The employer will therefore not declare any output tax on the fringe benefit in these cases. *Refer also to **paragraph 11.11**.*

#### 4.3.9 Ships’ crew

The wording of proviso (viii) to section 17(2)(a) is as follows:

*(viii) such goods or services consist of a meal or refreshment supplied by the vendor as operator of any ship or vessel (otherwise than in the circumstances contemplated in subparagraph (iii)) in such ship or vessel to a crew member of such ship or vessel, where such meal or refreshment is supplied in the course of making a taxable supply by that vendor; or*

The abuse that the previous wording of section 17(2)(a) intended to prevent was the claiming of an input credit where entertainment was provided in lieu of a salary. However, meals provided to cabin crew on board a ship or vessel is not the abuse that the provision intended to target. An amendment was therefore introduced to allow vendors that operate ships or vessels at sea in the course of making taxable supplies (e.g. fishing vessels, oil rigs, etc) to deduct input tax in respect of meals and refreshments supplied to the crew on board those ships or vessels.

Although proviso (viii) was only introduced on 24 January 2005, in practice, input tax was previously allowed in regard to subsistence costs for ships' crew under proviso (ii) from September 2002, provided that the crew spent at least a night away at sea. (Refer to **paragraph 4.3.3.**)

This provision is similar in nature to proviso (iii) which was discussed in **paragraph 4.3.3**, however, that provision only applies "... otherwise than in the circumstances contemplated in subparagraph (iii)..." Therefore, proviso (viii) will not apply to the extent that input tax may be claimed under proviso (iii) on expenses incurred to provide entertainment such as meals, refreshments or other on-board entertainment as an integral part of a taxable transportation service.

#### **Example 14 – Meals provided to crew on board a fishing trawler**

##### *Scenario*

A vendor operates a fishing business with a fleet of five fishing trawlers. The crew on four of the trawlers spend an average of eight days at sea per fishing trip, whereas the one trawler is only used for daytime fishing expeditions of up to 10 hours. Meals are provided to crew on all fishing trips by the employer.

##### *Question*

Is the vendor entitled to claim input tax on the food and beverages provided to the crew?

##### *Answer*

Yes, the input tax may be claimed in respect of meals provided to the crew on all five trawlers. Under proviso (viii) to section 17(2)(a), it is not a requirement that the crew must spend nights away at sea for the employer to qualify for the deduction. For the period September 2002 to 23 January 2005, an input tax deduction would have been allowed under proviso (ii) to section 17(2)(a), provided that the crews aboard the fishing trawlers were spending nights away from their usual place of residence and usual working-place (i.e. the place where the crew are stationed).

#### **4.3.10 Prizes**

The wording of proviso (ix) to section 17(2)(a) is as follows:

*(ix) that entertainment is acquired by the vendor for the purpose of awarding that entertainment as a prize contemplated in section 16(3)(d) in consequence of a supply contemplated in section 8(13);*

This provision was introduced with effect from 1 February 2006 to provide that input tax be allowed in circumstances where VAT is incurred on the acquisition of entertainment which is awarded as a prize to clients or customers in consequence of a bet received by the vendor on the outcome of a race or some other unpredictable event.<sup>22</sup>

The input tax is subject to the following conditions:

- It is limited to the actual VAT incurred on the original cost of acquisition (i.e. not on the open market value or the advertised retail value).
- The VAT may only be claimed in the tax period in which the prize is awarded, and not in the tax period when the entertainment is originally acquired.

<sup>22</sup> The provision is intended mainly for vendors who conduct betting businesses where entertainment is continuously or regularly supplied as competition prizes which are intended to promote the other products which are normally supplied by that vendor (e.g. casinos). However, the application of this provision could also apply to once-off events which have an entertainment prize such as a holiday, provided that the transaction which gave rise to the entertainment prize was a betting transaction. Refer to Interpretation Note No. 41 – (Issue 2) (31 March 2008) – Application of VAT to the gambling industry for more details in this regard.

**Example 15 – Entertainment prize awarded in consequence of a bet***Scenario*

A casino operator holds a competition where the jackpot prize on a certain slot machine constitutes a two week all-expenses paid vacation at an exclusive hotel in Cape Town which is advertised as being worth R50 000. In March 2009, a customer wins the prize and goes on the trip during April 2009. In May 2009, the casino operator receives a tax invoice from the hotel for the full invoice amount of R32 000.

*Question*

Can the casino operator claim input tax on the entertainment prize awarded?

*Answer*

The casino operator may claim input tax in the tax period which covers the month of May 2009, based on a consideration of R32 000 paid, and not on the advertised value of R50 000.

**4.3.11 Foreign donor funded projects**

A foreign donor funded project is a development project which is funded under an international agreement between the South African government and a foreign government, or other International Development Agencies (IDAs). International agreements with foreign governments and IDAs normally provide that the funds donated should only be used for specific, mutually agreed upon programmes and activities, and cannot be used for any taxes imposed under South African law. Section 17(2A) therefore provides that in such cases, the general disallowance rule under section 17(2)(a) in respect of entertainment expenses does not apply to foreign donor funded projects.

This means that a person that has been appointed by a foreign donor to administer the project can register for VAT as a “foreign donor funded project” and may claim a refund of the VAT paid on goods and services acquired for the project. A person that qualifies as a “foreign donor funded project” must register the project separately from any existing VAT registration.

If the “foreign donor funded project” is administered by a public authority, that public authority qualifies to register for VAT but the input tax claims are limited to the VAT incurred on goods or services acquired which are directly in connection with the implementation of the internationally funded project (including entertainment expenses). It does not entitle the public authority concerned to claim input tax on its own VAT-inclusive capital and operating costs.

Note that refunds granted under the foreign donor funded project dispensation must not be confused with the tax relief (refunds) which may be allowed to certain diplomats and diplomatic and consular missions under section 68, where that person enjoys full or limited immunity, rights or privileges. Any claim for a refund of tax under section 68 follows a separate process which is prescribed by the Commissioner and the Department of International Relations and Cooperation (formerly known as the Department of Foreign Affairs).<sup>23</sup>

<sup>23</sup> For more details on diplomatic refunds, refer to AS-VAT-02 – Quick Reference Guide (Diplomatic Refunds) (VAT 418).

## CHAPTER 5

### COMMERCIAL ACCOMMODATION EXPLAINED

#### 5.1 INTRODUCTION

The VAT treatment of supplies of accommodation by hotels, residential hotels and similar establishments changed with effect from 1 October 2001. A fundamental part of these changes involved the introduction of the definition “*commercial accommodation*” which replaced the previous definitions of “*commercial rental establishment*” and “*residential rental establishment*”.

To gain a full understanding of the application of the VAT law as it is today, it is useful to examine some of the history and background of the VAT rules pertaining to different types of supplies of accommodation. **Chapter 6** therefore deals with the VAT treatment of supplies of accommodation made by commercial rental establishments and residential rental establishments before 1 October 2001, before dealing with the current VAT treatment of commercial accommodation.

Furthermore, it is first necessary to understand the meaning of the term “*commercial accommodation*” as this is fundamental in determining whether a supply of accommodation will be taxable or exempt,<sup>24</sup> and whether the special value of supply rule for commercial accommodation is applicable or not. This chapter therefore unpacks the concept and discusses the various elements of the definition in some detail so that the reader will be able to understand the VAT treatment of various supplies made by accommodation establishments as set out in **Chapter 6**.

#### 5.2 PARAGRAPH (a) – COMMERCIAL ESTABLISHMENTS

This paragraph contains the general rules applicable to enterprises which supply commercial accommodation. The different elements contained in the definition can be broken down into the following components:

##### *Types of accommodation units*<sup>25</sup>

The list of places referred to in the law are: houses, flats, apartments, rooms, hotels, motels, inns, guesthouses, boarding houses, residential establishments, holiday accommodation units, chalets, tents, caravans, camping sites, houseboats and similar establishments. The list of places is not meant to include every possibility, and includes reference to “similar establishments”. This means that certain types of accommodation may still fall within the ambit of paragraph (a) of the definition if the board and lodging is provided in a similar establishment, and in similar circumstances to those listed. However, specifically excluded is a dwelling supplied in terms of an agreement for the letting and hiring thereof (being an exempt supply).

Typically the accommodation establishments in this paragraph are those which supply short-term business and leisure type accommodation as their core business activity. Examples include hotels and guesthouses. However, any person can supply commercial accommodation as long as all the requirements contained in paragraph (a) of the definition are met.

---

<sup>24</sup> The terms “*commercial accommodation*” and “*dwelling*” are mutually exclusive. Therefore, if the supply constitutes commercial accommodation the supply will usually be taxable, and the supply of accommodation in a dwelling is exempt. There are, however, some types of supplies described as “lodging or board and lodging” which are also exempt in certain cases. The VAT Act does not specifically characterise these supplies as either the supply of a dwelling, or the supply of commercial accommodation - it merely provides for those supplies to be exempt. (Refer to **Chapter 6** for further details.)

<sup>25</sup> The places in which “*commercial accommodation*” can be provided must be interpreted within the context of “lodging or board and lodging”. For example, a hospital or other medical facility may qualify, but the rental of an office, or exhibition space to conduct business, or the rental of a hall for purposes of holding a wedding reception does not constitute commercial accommodation.



Supplies may therefore be made through a formal commercial structure such as a hotel which has many units available for occupation, or through a less formal arrangement where a single apartment in a leisure resort is made available for holiday accommodation by the owner through an estate agent. The law does not concern itself with factors such as how many accommodation units must be available, the quality or type of facilities which should be available, or whether the accommodation is luxury or basic.

#### *Availability and frequency of supply*

The accommodation unit(s) must be regularly or systematically supplied. Although the phrase “regularly or systematically” is not defined, it is required that the units are available for occupation frequently enough over a period of time to establish a pattern, routine or schedule (although not necessarily a strict one). Further, that there should be a measure of intended sustainability and purposeful effort to make the accommodation unit(s) available for enterprise purposes in an organised manner. If the accommodation is supplied on a casual or *ad hoc* basis, it will not constitute the supply of commercial accommodation.

#### *Type and nature of supplies*

The type of supplies are described in the definition as “**lodging or board and lodging**”, together with “**domestic goods and services**”.<sup>26</sup> The terms “board” and “lodging” are not defined and therefore take their ordinary meaning. According to The Concise Oxford Dictionary, “lodging” means “*temporary accommodation*”, and “board” in the context of accommodation, means “*the provision of regular meals, usu. with accommodation, for payment*”. The Encarta Dictionary (English U.K.) defines the term “lodging” as “*somewhere to stay temporarily*”, and “*a room or rooms in a boarding house or private home available for rent*”. The term “board” in this context is defined as “*daily meals provided at the place where somebody lives, usually for money or in return for work*”.

The VAT Act defines “*domestic goods and services*” to include –

- cleaning and maintenance;
- electricity, gas, air conditioning or heating;
- a telephone, television set, radio or other similar article;
- furniture and other fittings;
- meals<sup>27</sup>;
- laundry; or
- nursing services.

This list is not exhaustive and other goods and services provided by the enterprise supplying the commercial accommodation could potentially qualify as domestic goods and services. However, the charges for these items will not necessarily qualify to be taxed under the special value of supply rules unless they are included in the all-inclusive tariff for the accommodation charged by the establishment.

In summary, the type of supplies included here are –

- the right to occupy the accommodation unit;
- the right to use any related facilities made available to the occupant included with the right of occupancy; and
- any meals, beverages or other supplies which may be regarded as domestic goods or services provided together with the accommodation, or provided separately, which supplies are incidental to, ancillary to, or in connection with, the supply of the commercial accommodation.

<sup>26</sup> The description links the two groups of supplies under paragraph (a) of the definition to ensure that the supply of a dwelling does not qualify as the supply of commercial accommodation.

<sup>27</sup> The reference to “meals” includes complimentary beverages such as tea, coffee and juice supplied as part of the meals included in the price of the commercial accommodation.

*Minimum threshold of R60 000 in a period of 12 months*

The total annual receipts from the supply of board, lodging and associated domestic goods and services must exceed R60 000,<sup>28</sup> or be reasonably expected to exceed that amount in a period of 12 months. The purpose of this threshold is to exclude a person from registering for VAT in respect of the provision of leisure type accommodation such as a holiday home which is of a casual, occasional or *ad hoc* nature. This also prevents a situation where persons with second homes or holiday homes register voluntarily in order to claim input tax deductions in respect of properties which are mainly used for personal consumption (dwelling or holiday purposes) by the owners or their guests.

Since the VAT Act no longer refers to any specific number of units which must be held for purposes of supplying commercial accommodation, the R60 000 threshold applies collectively to all the accommodation units available for occupation, and not to every individual place. Therefore, a person who supplies accommodation on a commercial basis together with domestic goods and services, may register for VAT voluntarily once the R60 000 threshold has been exceeded, or if it is likely to be exceeded within a 12-month period.

Whether a person meets this threshold requirement or not, is a matter of fact which must be established on the particulars of the case. For example, if an accommodation unit is continuously available for accommodation and an average monthly income of R6 000 is earned over the past 12 months, the requirement would be met (R6 000 x 12 = R72 000). But where the income from providing accommodation is more erratic over the 12-month period, evidence in the form of advance bookings, fixed contracts with corporate entities or tour operators, expected seasonal demand, or likely demand due to major events taking place in the area would be important factors to consider in determining if it is reasonable to expect that the R60 000 threshold will be attained.

### 5.3 PARAGRAPH (b) – OLD AGE HOMES AND OTHER CARE FACILITIES

This paragraph deals with places of accommodation such as homes for the aged, children, physically or mentally handicapped persons. The typical characteristics of this kind of accommodation are that –

- the residents are not staying at the accommodation establishment by choice, but rather due to circumstances beyond their control;
- the supplier will often (but not always) be an association not for gain or a welfare organisation;
- a high level of personal care and attention is provided to residents who depend on the supplier of the accommodation to take care of their day-to-day wellbeing;
- the accommodation establishment usually constitutes the place of residence of the occupant;
- residents stay for periods in excess of 28 days and the special value of supply rule will usually be applicable so that only 60% of the value of the commercial accommodation supplied (including the domestic goods and services) will be subjected to VAT at the standard rate.

Paragraph (b) of the definition does not contain specific conditions which have to be met in order for a person to qualify as a supplier of commercial accommodation as discussed in **paragraph 5.2** above. For example, there is no minimal turnover required.

Although no specific reference is made to the supply of domestic goods and services to qualify as “*commercial accommodation*”, as is the case in paragraph (a) of the definition, the supply of domestic goods and services is usually an integral part of the type of commercial accommodation supplied in the ordinary course of conducting the enterprise.

---

<sup>28</sup> Although always interpreted as such, it is only from 24 January 2005 that it has been expressly provided in the VAT Act that the carrying on of an activity involving the supply of board, lodging and domestic goods and services is not an enterprise if the R60 000 threshold requirement is not met, or is not reasonably expected to be met. Before 31 May 2003 the threshold was R48 000.

## 5.4 PARAGRAPH (c) – HOSPICES

The term “hospice” is not defined in the VAT Act and therefore takes its ordinary meaning. The Shorter Oxford English Dictionary defines the term as follows:

1. *A house of rest and entertainment for travellers or strangers, esp. one belonging to a religious order.*
2. *A home for the destitute or sick; spec. a nursing home for the care of the dying.*

The Encarta Dictionary (English U.K.) defines the term “hospice” as:

1. *Nursing home for dying. A usually small residential institution for terminally ill patients where treatment focuses on the patient's wellbeing rather than a cure and includes drugs for pain management, sometimes periods at home, and often spiritual counselling.*
2. *Refuge for travellers. Formerly, a place where pilgrims, travellers, and the homeless or destitute were offered lodging, usually by a religious order.*

According to the International Association for Hospice & Palliative Care, “Hospice and Palliative Care” is the active care of patients with advanced, progressive and incurable disease. Depending on the country, the meaning of “hospice” varies from a philosophy of care to the type of setting where the care is provided.<sup>29</sup> The World Health Organization (WHO) and the Hospice Palliative Care Association of South Africa (HPCA) also have definitions of “hospice” and “palliative care” to which they subscribe.<sup>30</sup>

From the above, it is apparent that a hospice is primarily concerned with making supplies of goods and services to patients (and families of patients) to help them deal with difficulties associated with life threatening illness. A hospice assists in this regard by providing palliative care and other support to residents and patients focusing on the prevention, treatment and relief of human suffering. From an analysis of these definitions within the context and structure of the VAT law, (besides the aspects which may fall within paragraph (a) of the definition of “commercial accommodation”), it becomes clear that this paragraph refers to a specific type of residential accommodation establishment which provides a high degree of personal care in regard to the wellbeing of terminally ill, homeless, destitute and dying persons.

As with paragraph (b) of the definition, paragraph (c) does not contain specific conditions which have to be met in order for a hospice to qualify as a supplier of commercial accommodation. As a hospice will usually be a “welfare organisation”, the supply of lodging, or board and lodging will not only constitute the supply of commercial accommodation, but also a “welfare activity” carried on in the course or furtherance of the hospice’s enterprise.

Although no specific reference is made to the supply of domestic goods and services to qualify as “commercial accommodation”, the supplier (hospice) under this paragraph will usually also supply domestic goods and services, together with the lodging or board and lodging, as well as other goods and services in the ordinary course of conducting the enterprise (which includes any welfare activity).

The typical characteristics of a hospice are almost identical to those set out in **paragraph 5.3** and therefore the VAT treatment of accommodation supplied by hospices will be the same as old age homes and other establishments falling within paragraph (b) of the definition of “commercial accommodation”.

In addition to the supply of board and lodging and domestic goods and services, a hospice would usually also provide the following:

- *Medical treatment and in-patient care* – where patients who cannot be medically treated at state hospitals any longer because their treatment has ceased are admitted for a short period of intensive medical care, including pain and other symptom control, or when the families need to have a break.

<sup>29</sup> IAPHC website: <http://www.hospicecare.com/Organisation/Org.htm#Definition>.

<sup>30</sup> National Cancer Control Programmes: Policies and Managerial Guidelines, 2<sup>nd</sup> Ed. Geneva: WHO, 2002; and HPCA website: <http://www.hospicepalliativecaresa.co.za/What%20is%20palliative%20care.htm>.

- *Day care* – where patients come to the hospice day care centre to enjoy a social outing, a cooked meal and be medically assessed. They may also take part in various social and entertainment activities such as listening to music, watching a show, artwork, sewing or gardening.
- *Bereavement counselling* – where contact is maintained with the family after the death of the patient for as long as needed to provide the necessary social support in overcoming their bereavement.
- *Home care nursing* – where patients are cared for in their own homes and a specially-trained nursing sister assesses the patient, visits the patient on a regular basis at home and provides physical care, emotional support and practical help for everyday living.<sup>31</sup>
- *Welfare and fundraising activities* – as hospices are welfare organisations which carry on welfare activities, they will often carry on fundraising activities and be involved with social activities which are in the interests of entertaining the elderly, sick and dying.

Refer also to **paragraph 4.3.7** in regard to input tax which may be claimed by welfare organisations.

---

<sup>31</sup> It should be noted that only the “nursing services” will qualify as “*domestic goods and services*” as defined. Therefore any charges for nursing services which fall within the normal role and function of a nurse in seeing to the day-to-day needs of a resident at the hospice may be charged with VAT under the special value of supply rule in section 10(10). However, this does not include fees for the supply of other medical goods and services such as doctor’s fees, medicines, medical equipment, x-rays etc. The same will apply where nursing services are part of the domestic goods and services supplied at an old age home or other care facility as discussed in **paragraph 5.3**.

## CHAPTER 6

### VAT TREATMENT OF ACCOMMODATION ESTABLISHMENTS

#### 6.1 EXEMPT ACCOMMODATION

##### 6.1.1 Introduction

The VAT treatment of exempt supplies is that no output tax is levied on the supply, and no input tax may be claimed on any goods and services acquired for the purpose of making these supplies, even if that person is a vendor for other types of supplies. Vendors that make both taxable and exempt supplies must only charge VAT and account for output tax on taxable supplies made. Similarly, input tax may only be claimed where goods and services acquired are directly attributable to the making of those taxable supplies. Where direct attribution is not possible, an apportionment of input tax will have to be made which represents a fair and reasonable proportion of the extent of taxable supplies. (Refer to Chapter 7 of the VAT 404 Guide for Vendors for more details in regard to apportionment and direct attribution.)

These principles will apply in respect of the different types of exempt or non-taxable accommodation discussed in paragraphs 6.1.2 to 6.1.6 below and will not be repeated under those headings.

##### 6.1.2 Accommodation in a dwelling

The supply of a dwelling (or accommodation in a dwelling) under an agreement for the letting and hiring<sup>32</sup> thereof is exempt from VAT in terms of section 12(c)(i). Refer to **paragraph 2.6** which provides the characteristics of a dwelling as well as guidelines on how to distinguish the supply of a dwelling from the supply of commercial accommodation. Refer also to **Chapter 5** which discusses the meaning of the term “commercial accommodation”.

When furniture and fittings are supplied together with a dwelling under a lease agreement and included in the agreed rental charge, no apportionment of the rental is required in respect of the furniture and fittings. Therefore, the entire rental charge for the supply of a fully or partially furnished dwelling under a lease agreement will be exempt from VAT. However, if the lessor is a vendor, and other goods or services are supplied separately by that lessor for a separate consideration to the tenant, the supply may be subject to VAT. For example, if the lessor is registered for VAT in respect of a garden service business, any garden services provided to the tenant will attract VAT at the standard rate if the charge is not included in the monthly rent payments which are payable under the lease agreement for the dwelling.

##### 6.1.3 Life rights

Also exempt in terms of section 12(c)(i) is the supply of any “right of occupation”<sup>33</sup> as defined in section 1 of the Housing Development Schemes for Retired Persons Act, 1988 (which by definition includes a “housing interest”).<sup>34</sup>

<sup>32</sup> This is a reference to what is commonly known as an “agreement of lease”, “rental agreement”, or “lease agreement”.

<sup>33</sup> The Housing Development Schemes for Retired Persons Act defines a “right of occupation” as follows: means the right of a purchaser of a housing interest—

- (a) which is subject to the payment of a fixed or determinable sum of money by way of a loan or otherwise, payable in one amount or in instalments, in addition to or in lieu of a levy, and whether or not such a sum of money is in whole or in part refundable to the purchaser or any other person or to the estate of the purchaser or of such other person; and
- (b) which confers the power to occupy a portion in a housing development scheme for the duration of the lifetime of the purchaser or, subject to section 7, any other person mentioned in the contract in terms of which the housing interest is acquired, but without conferring the power to claim transfer of the ownership of the portion to which the housing interest relates;

<sup>34</sup> The Housing Development Schemes for Retired Persons Act defines this term as follows: “Housing interest”, in relation to a housing development scheme, means any right to claim transfer of the land to which the scheme relates, or to use or occupy that land.

In layman's terms, this is the acquisition of a right of occupation in a retirement village by a person who is 50 years of age, or older. The supply of life rights is viewed as being the same as (or similar to) the supply of accommodation in a dwelling under an agreement for the letting and hiring thereof which was discussed in **paragraph 6.1.2**.

In the case of a developer conducting a housing development scheme<sup>35</sup> under the said Act, the capital of the developer is the property units which are employed in the business by either –

- (a) selling the units under sectional title share block scheme to the purchasers; or
- (b) granting the right of use (occupation) of the units by way of selling life rights to the occupiers.

In the case of (a) above, the supply constitutes “*fixed property*” which is subject to VAT at the standard rate. However, the consideration<sup>36</sup> (or *quid pro quo*) paid in terms of the contract for the granting of the right of occupation in (b) above is exempt.

Although the exemption was only formally included in section 12(c)(i) from 24 January 2005, the amendment did not introduce anything new – it merely clarified an existing policy and practice that allowed the exemption to apply.

#### 6.1.4 Lodging or board and lodging supplied by employers to employees

Section 12(c)(ii) provides an exemption for “lodging or board and lodging” provided by an employer to an employee<sup>37</sup> in the following circumstances:

- Where the employee (or other person) is entitled to occupy the accommodation as a benefit under an employment contract and where that right of occupation is limited to the period of employment, term of office, or other agreed period in terms of that employment contract.
- Where the employer provides accommodation to an employee (or other person) in a hostel or boarding establishment which is solely or mainly for the benefit of employees, and which is operated by that employer otherwise than for the purpose of making profit.

The exemption dealt with in this paragraph is different from the one discussed in **paragraph 6.1.2** in the following respects:

- The accommodation is provided as a result of an employment contract, or as a benefit of employment in lieu of salary or wages.
- The wording of the exemption refers to “lodging or board and lodging”, and not to a “*dwelling*” (as defined). The provision therefore exempts what may potentially have otherwise been regarded as commercial accommodation.

The incidental supply of accommodation and meals to persons other than employees will not be taxable, if those facilities are used **mainly for the benefit of the employees** of the employer that supplies the accommodation. However, it is common in some industries (for example, in mining) for the activity of the provision of “housing” to employees to be outsourced to a third party sub-contractor. It is common in these arrangements that the employer supplies the buildings, facilities and amenities to the sub-contractor, who in turn, supplies accommodation to the employer's workers.

<sup>35</sup> The term is defined as follows: “*Housing development scheme*” means any scheme, arrangement or undertaking—  
(a) in terms of which housing interests are alienated for occupation contemplated in section 7, whether the scheme, arrangement or undertaking is operated pursuant to or in connection with a development scheme or a share block scheme or membership of or participation in any club, association, organization or other body, or the issuing of shares, or otherwise, but excluding a property time-sharing scheme; or

(b) declared a housing development scheme by the Minister by notice in the Gazette for the purposes of this Act;  
<sup>36</sup> In the case *Commissioner, SARS v Brummeria Renaissance (Pty) Ltd* [2007] SCA 99 (RSA) it was confirmed that for income tax purposes, an amount must be calculated to determine the consideration for the right to use loans interest-free for such life rights, which amount had to be included in “*gross income*” which “*accrues*” to a taxpayer. The monetary value of the benefit so determined would also constitute the consideration for the supply of the right of occupation for purposes of the VAT exemption.

<sup>37</sup> Referred to as the “*recipient*” in section 12(c)(ii)(aa) and (bb). This is to provide for a situation where another person (for example a family member of the employee) is provided with accommodation in the facility, either together with the employee, or in separate unit.

In such cases, the contract between the employer and the third party, as well as any contract between the employees and the employer, or the third party must be examined to determine the taxable nature or otherwise of each supply.

### 6.1.5 Lodging or board and lodging supplied by educational institutions<sup>38</sup>

Section 12(h)(ii) provides for a similar exemption to the one discussed in **paragraph 6.1.4** for the supply of lodging or board and lodging, by an educational institution to learners or students, if all of the following conditions are met:

- (a) The supplier must be an educational institution mentioned in section 12(h)(i) which supplies exempt educational services, e.g. a school, university, technikon or college.
- (b) The goods and services<sup>39</sup> supplied must be **solely or mainly<sup>40</sup> for the benefit of the educational institution's learners or students.**
- (c) The supplies must be necessary for, and subordinate and incidental to, the supply of the educational services mentioned in paragraph (a) above.

The same principle applies as discussed in **paragraph 6.1.4** when accommodation and meals are supplied to other persons, in that, the supplies will not be taxable as long as the type of supplies usually made with those accommodation units and related facilities are solely or mainly for the benefit of the educational institution's own learners or students.

Whilst the lodging or board and lodging must be necessary for, subordinate and incidental to the educational services, it is not a requirement that the goods and services must be supplied by the same educational institution. For example, accommodation might be provided at one institution, but lectures may take place at another institution.<sup>41</sup> It also does not matter if the charges for board and lodging or other items such as study material are itemised separately from the bare tuition fee. The exemption will apply as long as those goods and services are necessary for, subordinate and incidental to the educational services.

When an educational institution supplies accommodation or meals to educators (teachers or lecturers) for no consideration, or for a consideration which does not cover all the direct and indirect costs of making those supplies, the value of supply is deemed to be nil and the educational institution will not be entitled to claim any input tax in this regard (even if it is vendor for other taxable supplies which it makes). Alternatively, if the meals and accommodation are of the type supplied mainly for the benefit of students, any consideration paid for those supplies is exempt.

However, a distinction must be made between goods and services supplied by the educational institution as an integral part of the education, and any other supplies which are made separately and which may be taxable, such as:

- Supplies made by the educational institution itself which are not necessary for, subordinate and incidental to the educational services, or which are not solely or mainly for the benefit of students.<sup>42</sup>
- The supply of fixed property under a lease agreement to independent vendors operating on the premises of the educational institution (e.g. a university bookshop or a restaurant).

<sup>38</sup> The reference to educational institutions as discussed in this paragraph does not include public schools, as they are regarded as part of the Department of Education which is a public authority and may not register for VAT.

<sup>39</sup> Constituting accommodation, meals and various other supplies in the nature of "domestic good and services" supplied together with the accommodation.

<sup>40</sup> The word "mainly" is interpreted to mean greater than 50%.

<sup>41</sup> The educational institution which provides the education levies the tuition fees taking into account the costs of the entire exempt educational package of goods and services provided to the student or learner in return for those fees. Whether the educational institution is actually able to accommodate or feed the students with its own physical resources or whether it will pay another person to carry out these activities on its behalf is irrelevant for the purposes of applying the exemption.

<sup>42</sup> For example, supplies made via vending machines and other coin-operated entertainment devices, rental of sporting facilities and halls for private functions, advertising services rendered in return for sponsorships or other forms of payment, or entrance fees charged to attend sporting events.

### 6.1.6 Other non-taxable supplies of accommodation

In situations other than the ones discussed in **paragraphs 6.1.2 to 6.1.5** above, it will generally be found that the accommodation supplied is taxable “commercial accommodation” and that the person making the supply is liable to register for VAT, or has registered voluntarily. However, there are some other instances in which the accommodation supplied will not be taxable. For example, where the supplier does not meet the R60 000 minimum threshold to qualify as an enterprise supplying commercial accommodation, or where the R60 000 threshold is met, but the person has chosen not to register voluntarily for VAT. Another situation is where the accommodation is supplied by a person who is registered for Turnover Tax, as that person would be prohibited from registering for VAT and therefore cannot charge VAT.

## 6.2 TAXABLE SUPPLIES OF ACCOMMODATION (BEFORE 1 OCTOBER 2001)

Before the changes to the VAT law which came into effect on 1 October 2001, the law made a distinction between “*commercial rental establishment*” and “*residential rental establishment*” – terms which were defined. (Refer also to **Chapter 2** for a discussion on the term “*dwelling*”.)

### 6.2.1 Commercial rental establishments

The VAT Act distinguished between five different types of commercial rental establishments, namely:

(a) *Hotel and similar types of accommodation establishments* – this included hotels, motels, inns, boarding houses, hostels or similar establishments in which lodging was regularly or normally provided to five or more persons at a daily, weekly, monthly or other periodic charge. The characteristics of this type of accommodation being that –

- lodging is provided by the establishment;
- facilities exist for more than one group of people at a time;
- the owner or employees of the establishment are generally in attendance at the site; and
- generally a guest would stay in the accommodation for a relatively short period of time.

The operation of non-profit-making hostels by employers and local authorities were specifically excluded from qualifying as commercial rental establishments. The supply of any accommodation units in these establishments were therefore not regarded as taxable supplies.

(b) *Commercial letting enterprises* – these consisted of accommodation units such as houses, flats, apartments, rooms, caravans, houseboats, caravan or camping sites which are made available and which meet **all** of the following conditions:

- (i) Five or more of such units were required to be let or held for letting as residential accommodation in the course of the business undertaking.
- (ii) Total annual receipts and accruals from the letting of all such units had to exceed R24 000 or there had to be reasonable grounds for believing that the total annual receipts and accruals will exceed that amount.
- (iii) The accommodation units had to be regularly or normally let or held for letting as residential accommodation for continuous periods not exceeding 45 days in the case of each occupant.

The first two requirements were intended to exclude business undertakings where the business of letting was more likely to be of a casual nature whereas the third requirement was intended to exclude business undertakings providing residential accommodation on a long term basis.

Where a separately identifiable part of a business undertaking did not meet these requirements, for example, where accommodation units were usually let or held for letting for periods in excess of 45 days, those supplies were not regarded as taxable supplies.



- (c) *Other letting enterprises* – These included establishments which supplied accommodation units such as houses, flats, apartments or rooms which did not qualify as one of the accommodation establishments discussed under paragraphs (a) or (b) above. This applied in the cases of persons letting or holding for letting up to four different houses, flats, apartments or rooms. Each house, flat, apartment or room had to be tested against the requirements as set out in (ii) and (iii) in paragraph (b) above. A person who let these types of accommodation units on a casual or sporadic basis could not qualify as a commercial rental establishment and the units supplied under such circumstances were not regarded as taxable supplies.
- (d) *Medical or care facilities* – Accommodation supplied in any hospital, nursing home, hospice, convalescent home or rest home fell within the classification of accommodation supplied in a commercial rental establishment. However, if the medical or care facility was operated by a public authority or local authority/municipality, the supply of the accommodation fell outside the scope of VAT, as public authorities and local authorities/municipalities were not regarded as commercial rental establishments.
- (e) *Prison accommodation provided by third parties* – With effect from 24 November 1999 (and until the VAT Act was further amended with effect from 1 October 2001), the definition of “*commercial rental establishment*” included prisons or other places of detention which were managed by persons other than public authorities, but in terms of agreements with public authorities.

### 6.2.2 Residential rental establishments

In addition to the five types of commercial rental establishments discussed above, the law also provided for a sixth type of commercial rental establishment known as a “*residential rental establishment*”<sup>43</sup> which term was separately defined. The essential characteristics of a residential rental establishment were that -

- the establishment had to qualify as a commercial rental establishment as discussed under paragraphs (a) and (d) above; and
- 70% or more of the residents had to reside, or be expected to reside in the establishment for periods in excess of 45 days.

### 6.2.3 Application of the special value of supply rules

Before 1 October 2001, the valuation rules for supplies of accommodation and other domestic goods and services under section 10(10) were as follows:

- *Commercial rental establishments*

If the accommodation (including domestic goods and services) was provided for a period of 45 days or less, VAT was levied at the standard rate on the full value of supply. Where the supply was for a period exceeding 45 days, only 60% of the value attributable to the portion exceeding 45 days was subject to VAT at the standard rate. If the accommodation was provided at an all-inclusive charge, a split between the charges for accommodation and domestic goods and services on the one hand, and meals and other services on the other hand was required. At least 20% of the value of supply had to be attributed to the “meals and other services” unless the Commissioner directed otherwise. The purpose being that the value attributable to “meals and other services” would always be taxed in full at the standard rate even when the accommodation was supplied for a period exceeding 45 days.

- *Residential rental establishments*

When accommodation and domestic goods and services were supplied by agreement for a period of 45 days or longer, or for successive periods which in aggregate exceeded 45 days, only 60% of the value was subject to VAT from the first day on which the supply commenced.

<sup>43</sup> Typical examples included residential hotels, boarding establishments, hospices, convalescent homes and old age homes.

## 6.3 TAXABLE COMMERCIAL ACCOMMODATION (FROM 1 OCTOBER 2001)

### 6.3.1 Overview of amendments

The Revenue Laws Amendment Act, No. 19 of 2001 (with effect from 1 October 2001) and the Second Revenue Laws Amendment Act No. 60 of 2001 (with effect from 7 November 2001) brought about various changes to the VAT law to achieve the objective of simplifying the VAT treatment of supplies of accommodation and domestic goods and services. The VAT laws in connection with the treatment of supplies of commercial accommodation, domestic goods and services and dwellings have also been subject to many changes since 2001. An overview of these changes and the effect thereof are summarised briefly below:

- *Definition of “commercial accommodation”*<sup>44</sup> – A new definition “*commercial accommodation*” was inserted. The definition only has three categories of accommodation, instead of the six categories under the previous definitions of “*commercial rental establishment*” and “*residential rental establishment*”. Other important changes were –
  - the total annual receipts and accruals from the supply of accommodation units (including domestic goods and services) increased from R24 000 to R48 000<sup>45</sup> (the threshold is currently R60 000);
  - the requirement that the vendor must regularly or normally let, or hold for letting, five or more units as residential accommodation for continuous periods not exceeding 45 days fell away; and
  - commercial accommodation must be regularly or systematically supplied<sup>46</sup> (as opposed to the previous wording which referred to “regularly or normally provided”).
- *Definition of “domestic goods and services”* – From 1 October 2001, the list of domestic goods and services was extended to include furniture and fittings as well as meals. The definition was later extended to include laundry and nursing services.<sup>47</sup>
- *Definition of “dwelling”* – Textual amendments were made to delete reference to the term “*commercial rental establishment*”, and to include reference to “*commercial accommodation*”. Further textual amendments were made with effect from 7 November 2001, to make it clear that a supply of commercial accommodation does not take place when a “*dwelling*” (as defined) is let to a person.
- *Value of supply* – The valuation rules in sections 10(10)(a), (b) and (c) were consolidated and simplified to establish a single provision relating to supplies of accommodation and domestic goods and services. This included a change in the special valuation rule which applies in such cases where the resident or guest stays for a continuous period which was longer than 28 days, in which case the VAT is calculated on only 60% of the all-inclusive charge from the first day<sup>48</sup>.
- *Exemption – supply of a dwelling under section 12(c)* – Two further paragraphs were added to clarify that where the supply was of an accommodation unit in a hostel which was operated by the employer of the residents, or by a local authority/municipality on a not-for-profit basis, the supply is exempt from VAT.

<sup>44</sup> Refer also to **Chapter 5** for a detailed explanation of the meaning of the term “*commercial accommodation*”.

<sup>45</sup> Amended in terms of the Exchange Control Amnesty and Amendment of Taxation Laws Act, No. 12 of 2003 (Promulgation date: 31 May 2003) (GG No. 25047).

<sup>46</sup> Initially the wording was “regularly or systematically let”, but the word “let” was later replaced with the word “supplied” to avoid any confusion with regard to the wording of the exemption under section 12(c)(i) which refers to an agreement for the “letting and hiring” of a dwelling.

<sup>47</sup> Amended in terms of Revenue Laws Amendment Act, No. 32 of 2004 (Promulgation date 24 January 2005) (GG No. 27188).

<sup>48</sup> Before the amendment, the special value of supply rule only applied to stays exceeding 45 days, and then it only applied from the 46<sup>th</sup> day, and not from the first day of the stay.

### 6.3.2 Application of the special value of supply rules

When commercial accommodation is supplied to a person for a period of 28 days or less, the full amount charged for the accommodation and any domestic goods and services (or any other supplies) are subject to the VAT at the standard rate. However, if the person stays for an unbroken period of 29 days or more, only 60% of the all-inclusive charge for the accommodation and any domestic goods and services included in the all-inclusive tariff for the accommodation is subject to VAT at the standard rate.

#### *Unbroken period in excess of 28 days*

Sometimes it can be established by the accommodation establishment at the beginning of the period that the resident or guest will stay for an unbroken period in excess of 28 days, but in some cases, this is only established after a period of time. Alternatively, there may be uncertainty as to whether the special value of supply rule will apply. For example, if a person books into a guesthouse for an initial period of 28 days or less, but ends up staying for longer than 29 days (or *vice versa*).

The application of the special valuation rule in such cases is that if there was no agreement that the stay would be for longer than 28 days, but the resident or guest eventually stays for longer than 28 days, VAT is calculated on 60% of the all-inclusive charge with effect from the first day. If any payments have already been made and VAT has been calculated on the full all-inclusive charge, the consideration would have to be altered and an adjustment made. If any tax invoices have been issued on the basis of the previously agreed consideration, a credit note should be issued to correct the position.

In the event that there is an initial agreement that the resident or guest will stay for longer than 28 days, but the person vacates the accommodation before the 29<sup>th</sup> day, the supplier will be required to make the necessary adjustments so that the special value of supply rule does not apply. However, in the event that the resident or guest passes away before the 29<sup>th</sup> day, the VAT may still be calculated on 60% of the all-inclusive charge from the first day.<sup>49</sup>

#### *All-inclusive charge*

Refer to **paragraph 2.2** for a discussion on the meaning of this term. If the all-inclusive charge includes supplies which do not constitute domestic goods and services and the accommodation is supplied for an unbroken period of more than 28 days, a split will have to be made in the consideration, as the value of those other goods and services will not qualify to be taxed under the special valuation rules.

In cases where the special valuation rule applies, the consideration in money is deemed to be 60% of the all-inclusive charge. The VAT 201 return requires that for the tax period concerned, the total amount (excluding VAT) in respect of commercial accommodation and domestic goods and services supplied for a period in excess of 28 days must be inserted in Field 5. As a VAT-exclusive amount is required for the purposes of completing the VAT 201 return, the VAT calculation and how the vendor completes the return will depend on whether the all-inclusive charge is a VAT-inclusive or VAT-exclusive amount.

When the all-inclusive charge is VAT-exclusive, the calculation is fairly simple. All that is required is that the VAT-exclusive amount is multiplied by 60%, and then by 14%. However, if the all-inclusive charge by the accommodation establishment is VAT-inclusive, the VAT is calculated as follows:

$$\text{VAT} = \text{All-inclusive, VAT-inclusive charge} \times (14/114 \times 60\%).$$

---

<sup>49</sup> Refer to VAT News No. 17.

**Example 16 – Calculation of VAT on all-inclusive prices***Scenario*

Not-So-Fancy Hotel has just opened for business and has registered as a vendor. The owner, Mr Fancy, decides that he will charge his customers R230 per day (excluding the charge for VAT) where the person stays for a continuous period of 29 days or more. The charge is an all-inclusive amount for the accommodation and includes breakfast and other domestic goods and services that come with room. The hotel's first and only customer for the tax period is Mrs Guest who stays for a 30-day continuous period.

*Question*

Calculate the VAT-inclusive daily rate that Mr Fancy would charge Mrs Guest. Also calculate the VAT which must be declared in respect of Mrs Guest's stay and the value of supply for completing Fields 5, 6 and 9 of Not-So-Fancy Hotel's VAT 201 return for the tax period concerned.

*Answer*

VAT inclusive daily rate = R230 + [(R230 x 60%) x 14%]	= <b>R249.32</b>
Value of supply = R230 x 30 days	= R6 900
Total amount (excluding VAT) (Field 5)	= R6 900
Taxable value (excluding VAT) (Field 6) = R6 900 x 60%	= R4 140
VAT (Field 9) = R4 140 x 14%	= <b>R579.60</b>

*Domestic goods and services*

When an accommodation establishment includes the cost of supplying any domestic goods and services, in an all-inclusive daily, weekly or monthly tariff for the accommodation, only 60% of the all-inclusive charge will be subject to VAT at the standard rate. The full value of goods or services supplied by the accommodation establishment which do not fall within the definition of "*domestic goods and services*" will always attract VAT at the standard rate whether included in the all-inclusive tariff or not.

The term "*domestic goods and services*" is defined as follows:

*means goods and services provided in any enterprise supplying commercial accommodation, including-*

- (a) *cleaning and maintenance;*
- (b) *electricity, gas, air conditioning or heating;*
- (c) *a telephone, television set, radio or other similar article;*
- (d) *furniture and other fittings;*
- (e) *meals;*
- (f) *laundry; or*
- (g) *nursing services.*

The use of the word "including" in the definition means that potentially, certain goods or services not listed, may also fall within the definition, and hence qualify to be taxed under the special value of supply rule. However, the goods and services which are intended to fall within this definition are limited to the type of supplies which are an integral, necessary, or ancillary part of the supply of the accommodation. Further, the supplies contemplated in the definition must be consistent with the "domestic" context of that provision.

The Encarta Dictionary (English U.K.) defines the term "domestic" in this context as –

1. *relating to home; relating to or used in the home or everyday life within a household*

The Shorter Oxford English Dictionary defines the term as –

1. *Of, or pertaining to one's home, house or household; pertaining to one's home or family affairs.*

It follows that the goods or services which may be regarded as domestic goods and services included in the all-inclusive charge by the supplier of the commercial accommodation includes the use and enjoyment of facilities and amenities which a person would normally expect to be available in a domestic situation in a home, even though they might not be specifically listed in the definition. Examples include the supply of water to the accommodation unit, as well as the supply of beverages such as tea, coffee and fruit juice (included in the all-inclusive charge) which are supplied together with meals.

Examples of supplies which are intended to be excluded from the meaning of “*domestic goods and services*” and which may **not** be taxed under the special value of supply rule include –

- game viewing;
- vouchers for gambling or other entertainment;
- body massages and health products;
- escort and dating services.
- travel arrangements;
- currency exchange; and
- medication, doctor’s services and other medical services (not being nursing services).

## 6.4 SUPPLIES TO STAFF

### 6.4.1 Accommodation

Any accommodation supplied to an employee in a hostel or other dwelling as a benefit of employment and which is available for the period of employment or some other period agreed upon by the employer and employee is exempt from VAT. Accommodation supplied to an employee will amount to accommodation supplied in a dwelling if the employee is accommodated –

- in a separate house, flat or other structure which does not form part of the structure of the building used to provide commercial accommodation; or
- in a room or accommodation unit which forms part of the structure of the building used to supply commercial accommodation, but which has been set aside exclusively for accommodation by employees; or
- in a hostel operated by the employer otherwise than for profit.

In these instances no VAT should be levied on any charge made by the employer to the employee in respect of the accommodation. Any VAT incurred on goods or services acquired in order to supply that accommodation will constitute a cost to the employer as it may not be claimed as input tax. The accommodation supplied to the employee in such cases does not constitute a taxable fringe benefit for VAT purposes<sup>50</sup> and therefore the employer is not liable to account for any output tax thereon.

However, when accommodation is supplied to an employee in any room or other unit used to provide commercial accommodation which has not been set aside exclusively for accommodation by employees, the supply will attract VAT at the standard rate.<sup>51</sup> When the accommodation is supplied for no charge, or for a charge which is less than the open market value, a taxable fringe benefit will arise on the difference between the charge and the open market value (which is the usual charge for that accommodation). In such cases, the employer must declare output tax on the fringe benefit.

### 6.4.2 Meals and refreshments

If meals or refreshments are supplied at no charge to the employee, a fringe benefit arises, but as the value of the benefit for income tax is nil, the same value is applicable for VAT purposes. The employer is therefore not liable to account for any output tax on the meal supplied to the employee in this case.

---

<sup>50</sup> Refer to the proviso to section 18(3) of the VAT Act.

<sup>51</sup> Subject to the application of the special value of supply rules where the employee stays for more than 28 days.

When a charge is made to employees in respect of meals or refreshments, VAT should be levied at the standard rate unless the accommodation establishment was denied an input tax credit on the goods or services acquired to supply those meals and refreshments. Usually an accommodation establishment which supplies meals and refreshments to guests will be entitled to claim input tax in respect of all goods and services acquired in this regard, even though a certain proportion of those purchases may be applied in providing meals to its staff. However, if the acquisition of goods or services can be attributed exclusively to the providing of meals or refreshments to staff an input tax credit is denied to the enterprise.

## 6.5 OTHER SUPPLIES

Vendors which supply commercial accommodation usually supply other entertainment goods and services in conjunction with, or in addition to, the supply of accommodation and domestic goods and services. These other supplies will generally attract VAT at the standard rate and the general time and value of supply rules will apply in most cases. However, for certain supplies, special rules may be applicable. The VAT implications of the supply of some of these other goods or services are discussed in paragraphs 6.5.1 to 6.5.6 below.

### 6.5.1 Entrance fees

VAT should be levied on any entrance fee or cover-charge paid by any patron of a bar, discotheque, lounge, swimming pool or other entertainment venue. When the entrance fee is charged by an independent entertainer<sup>52</sup> that is registered as a vendor, the entertainer must account for output tax on the entrance fee and not the accommodation establishment. However, there are a variety of contractual arrangements which may apply in such cases and the VAT treatment will depend on who stages the event, what supplies are made between the parties (or other outside contractors), and whether the parties to the agreement are VAT vendors or not. The contract between the entertainer and the establishment providing the venue will determine for whose benefit the entrance fee is charged and should provide details of any other supplies which may be necessary to stage the event. (*Refer to Chapter 10 for more details regarding entertainers.*)

For example, a hotel may stage an event and the entertainer's performance fee may be a certain percentage of the entrance fees charged and/or bar sales. In that case, the hotel will charge and account for the VAT collected from the patrons of the event and for the bar sales. If the entertainer is a vendor, he/she must account for output tax on the performance fee. The hotel must request the entertainer for a tax invoice in respect of the performance fee paid, and the hotel will be entitled to deduct the VAT so paid as input tax (subject to the rules discussed in Chapter 4).

Alternatively, the entertainer may stage the event and hire the venue and sound equipment from the hotel. In such a situation, the entertainer will charge and account for the VAT on any entrance fees collected from patrons and the VAT paid on the charge to hire the venue and any equipment may be claimed as input tax (subject to the rules discussed in Chapter 4).

### 6.5.2 Coin-operated machines and amusements

VAT is levied at the standard rate on any entertainment supplied via machines or devices which are operated by means of inserting a coin or token<sup>53</sup>. However, a special time of supply rule applies so that the supplier's liability for VAT only arises at the time the coins or tokens are removed from the machine.

---

<sup>52</sup> Not being an employee of the accommodation establishment and in a case where the entrance fee is charged for the entertainer's benefit.

<sup>53</sup> Although the law refers to devices which operate by the insertion of coins or tokens, it is submitted that this special time of supply rule also applies to devices which are capable of accepting paper money. Further, that where payment is effected directly to the supplier through the use of a debit card, credit card, smart card, or other means of electronic payment which do not require anything to be removed from the machine or device, the general time of supply rule will apply, and not the special rule.

This rule applies whether goods or services are supplied. Examples of goods supplied via vending machines or other coin-operated devices include cigarettes, cool drinks and sweets. Examples of services supplied via these devices include video games, table amusements such as pool and snooker, gambling, and squash court lighting.

A diversity of contractual arrangements may be used by the owners of vending and other coin-operated devices. In order to determine the VAT implications in any specific situation it is necessary to establish the terms of the agreement between the owner of the device and the person on whose premises the device is operated. A common arrangement is that the owner or lessee of the device is permitted to operate the machine on the premises of another person in return for a certain percentage of the takings. In these cases, the percentage of the takings is the method used to calculate the consideration for the granting of the right and VAT should therefore be levied at the standard rate thereon. However, the special time of supply will not be applicable to the granting of the right as that service is not made available via the coin-operated device.

### 6.5.3 Hiring of facilities and miscellaneous sales

Rentals or other charges for the provision of facilities such as entertainment halls, projectors, laptop computers, sound equipment and microphones attract VAT at the standard rate. The same applies for the sale of miscellaneous items such as curios and other paraphernalia. The general time and value of supply rules apply to these supplies.

However, where these sales are conducted by independent persons operating on the premises of the accommodation establishment, the sales will be taxable only if the independent person is a vendor. Rental charged by the accommodation establishment for office space or shop premises will attract VAT in the normal manner regardless of whether the tenant is a vendor or not. In the case of a rental agreement, a special time of supply rule applies, being the earlier of the time that a rental payment is due, or when it is received.

### 6.5.4 Guest transportation

It is common practice within the accommodation industry for hotels and guesthouses to offer their customers a courtesy transport service. For example, an airport shuttle transport service may be provided to hotel guests where they may be dropped off or collected from the airport.

#### *(a) Transportation supplied by the accommodation establishment itself*

Any charge made by an accommodation establishment for guest transportation is exempt from VAT (being the supply of transportation to fare-paying passengers). No VAT should therefore be charged by the accommodation establishment. Any VAT incurred on any goods or services acquired in order to supply the transportation service, for example, the acquisition of buses and mini-buses, spares and tyres, repairs and the maintenance of vehicles will not qualify as input tax and will constitute a cost to the accommodation establishment.

#### *(b) Transportation supplied by a subcontractor or independent third party*

If the transportation is supplied by a subcontractor to the accommodation establishment, which in turn, makes a supply of transportation to the guest (usually at a marked-up price), both amounts charged will be exempt from VAT. However, if the accommodation establishment merely acts as an agent for collection in respect of transportation provided by another person, the accommodation establishment will not levy any VAT on the charge made to the guest. In this situation the accommodation establishment does not make a supply to the guest as the charge by the third party is merely passed on to the guest in the form of a disbursement. The third party's charge will usually be exempt from VAT.

(c) *Game viewing*

Game farms and safari lodges often provide a service to guests where they can go on a game drive to view the wildlife on a farm or nature reserve. This type of service is not regarded as an exempt passenger transportation service and is subject to VAT at the standard rate<sup>54</sup>. Input tax may be claimed on the acquisition of a “*game viewing vehicle*” used to transport guests on game viewing expeditions if the person providing the taxable game viewing service is a vendor. However, if a minibus or other passenger vehicle falling within the definition of “*motor car*” is acquired and used for the same purpose, the input tax will be denied.

Game viewing services are not regarded as domestic goods and services and any charge for those services may not be subject to the special value of supply rule which may be applicable in cases where the guest stays for more than 28 days.

### 6.5.5 Tips for baggage handling or other services

Tips paid directly to porters and waiters which are employed by the accommodation establishment are regarded as payment for services rendered directly by the employee to the guest. As that person will not usually be registered for VAT, no VAT will be included in the payment. However, any service charge included in a hotel or restaurant bill which is levied by the accommodation establishment itself, will attract VAT at the standard rate in the normal manner, regardless of whether any amount is later passed on to the establishment’s employees or not.

### 6.5.6 Laundry services

Hotels and other accommodation establishments usually supply laundry and dry cleaning services. These services may be supplied by the establishment itself using its own facilities, or may be supplied via a subcontractor. A further possibility is that the accommodation establishment merely acts as an agent for the payment of the laundry service which is rendered by a third party to the guest.

(a) *Laundry services provided by the accommodation establishment itself*

Any charges for laundry, dry cleaning, ironing, mending and similar services attract VAT at the standard rate. These services constitute domestic goods and services and any charge in this regard may be subject to the special value of supply rule where the guest stays for more than 28 days.

(b) *Laundry services provided by a subcontractor or independent third party*

A supply by a subcontractor is usually characterised by the fact that the accommodation establishment charges its own rates which differ from the rates charged by the subcontractor. For VAT purposes, the accommodation establishment is the supplier of the laundry services and is required to levy VAT at the standard rate on any charges which it makes to the guest. The accommodation establishment will be able to claim input tax on any VAT-inclusive charge made by the subcontractor. However, an accommodation establishment may simply act as an agent for an independent third party providing the laundry services.

This arrangement is usually characterised by the fact that the accommodation establishment will recover the same amount from the guest as is charged by the third party, and that the laundry lists contained in the guest’s room will bear the name of the third party. In this situation the accommodation establishment is not supplying any goods or services and will not account for VAT. The charge by the third party, which may include VAT, is passed on to the guest in the form of a disbursement.

*For more information regarding the changes to the law which took place in October 2001, refer to **Annexure A** - Media Release No. 45 of 2001 - Changes to VAT on long term accommodation in hotels, boarding houses, retirement homes and similar establishments.*

---

<sup>54</sup> Refer to the clarifying amendment made to section 12(g) in terms of the Revenue Laws Amendment Act, 2004 with effect from 24 January 2005.



## CHAPTER 7

### INVOICING, TIME AND VALUE OF SUPPLY

#### 7.1 INVOICES AND TAX INVOICES

##### 7.1.1 Introduction

An “*invoice*” is broadly defined as any document which notifies the client or customer of an obligation to make payment. A clear distinction should be drawn between an invoice which determines in many cases the time that a supply takes place, and a tax invoice which is a specialised document required by legislation which reflects certain particulars for the purpose of claiming a deduction of input tax.

Although documents will often serve a dual role, namely that of an invoice and a tax invoice, it should be noted that a tax invoice does not necessarily constitute an invoice and *vice versa*. The general rules with regard to tax invoices, credit and debit notes are dealt with in Chapters 11 and 12 of the *VAT 404 – Guide for Vendors*.

When accommodation or other goods or services are supplied by an accommodation establishment to a vendor (or to an employee of the vendor), that person may require a tax invoice so that input tax may be claimed if the expense constitutes personal subsistence. (Refer to **paragraph 4.3.3**.)

##### 7.1.2 Tax invoices issued by agents

When the booking and arranging of accommodation is performed by a travel agent, the accommodation establishment will sometimes submit the tax invoice for the supply of accommodation to the travel agent for payment. This tax invoice should be passed on by the travel agent to the guest for the purpose of claiming input tax.

Any document issued by the travel agent to the guest will not constitute a tax invoice for the goods or services supplied by the accommodation establishment unless it has been agreed that the travel agent will issue tax invoices on behalf of the accommodation establishment. Note that two tax invoices may not be issued in respect of the same supply of goods or services. (Refer also to **Chapter 3**.)

##### 7.1.3 Tax invoices issued to guests

An accommodation enterprise will often issue the guest with a tax invoice upon departure from the accommodation establishment. Where this has been done, and payment is to be effected by a travel agent on behalf of the guest, a tax invoice may not also be issued by the accommodation establishment to the travel agent.

##### 7.1.4 Disbursements

An accommodation establishment may sometimes be requested to acquire goods or services on behalf of a guest. In this case, where the accommodation establishment acts as agent for the guest, the accommodation establishment should reflect any disbursements (amounts paid out on behalf of the guest) separately from the goods or services supplied by the accommodation establishment itself on the tax invoice to the guest. The tax invoices relating to these disbursements should be furnished to the guest so that input tax may be claimed (if entitled to do so). (Refer also to **Chapter 3**.)

## 7.2 TIME OF SUPPLY

### 7.2.1 General

As there is no special time of supply rule applicable for the supply of commercial accommodation, the general time of supply rule will apply. According to the general rule, a supply occurs at the earlier of the following events:

- At the time that an invoice is issued; or
- At the time any payment is received by the supplier.

However, if an accommodation establishment also supplies other goods or services where a special value of supply rule is applicable, the special rule must be applied and not the general rule. Examples include certain supplies between connected persons for no consideration, goods or services supplied via coin-operated devices such as vending machines, pool tables, etc.

One of the most important points to consider regarding the time of supply for accommodation concerns the payment of deposits and prepayments by guests (or their agents) in connection with the bookings. Whether the receipt of an amount in connection with a booking triggers the time of supply or not will depend on various factors. This aspect is discussed in some detail in **paragraph 7.2.2** below.

### 7.2.2 Deposits and prepayments for advance bookings

The definition of “*consideration*” was discussed in **paragraph 2.3** where it was mentioned that a “deposit” given in respect of a supply of goods or services is not regarded as payment made for the supply unless and until the supplier applies the deposit as consideration for the supply or the deposit is forfeited.

What this means in the context of the supply of commercial accommodation, is that if a guest pays a deposit to an accommodation establishment which is to be held as security for the performance of an obligation, it is not treated as consideration for a supply, unless the time of supply has already been triggered by the issuing of an invoice at that time. In this case there is no supply on which to account for any VAT. Further, what this implies is that for the amount to be regarded as a true “deposit” as envisaged in the definition of “*consideration*”, that payment should not have been in response to any invoice issued for the supply of accommodation by the establishment,<sup>55</sup> but rather some other document. For example, a contract or letter requesting the deposit payment and perhaps setting out the rules of the accommodation establishment, the terms and conditions applicable to deposit payments, and any possible forfeiture of part, or all of the deposit.<sup>56</sup>

If the deposit or any part thereof is later forfeited, the accommodation establishment will have to account for VAT at the time that the amount is –

- forfeited (usually when the guest cancels the booking or does not arrive); or
- applied as payment or part-payment of the consideration for a supply of goods or services.

---

<sup>55</sup> The reason is that the issuing of the invoice would trigger the time of supply for the accommodation. If the payment is in response to the issuing of the invoice, it is submitted that this constitutes a payment or prepayment of the consideration (or part thereof) for the supply of the accommodation.

<sup>56</sup> A typical example is that after enquiries have been made by the customer and a provisional booking is made by the accommodation establishment, a standard letter is faxed or e-mailed to the customer. The letter would contain the establishment’s banking details into which the “deposit” may be paid, details of the provisional booking, certain basic contractual details about the deposit and any forfeiture of the deposit, some of the rules of the establishment, directions to the establishment, etc. At this point there are usually no contractual rights and obligations – only an expectation that a contract may be concluded. Once the so-called “deposit” is paid or a prepayment has been made as requested by the establishment, that event will normally signify the confirmation of the booking and the conclusion of the contract which crystallises the supply and brings into effect the contractual rights and obligations.

But if the “deposit” is in fact part payment for the supply of the accommodation in the first instance, and not a security deposit, the time of supply for the accommodation will be triggered under the general time of supply rule as discussed in **paragraph 7.2.1** and a tax invoice must be issued within 21 days of that event.

In many cases these so-called “deposit” payments which accommodation establishments require to confirm a booking by a guest are really prepayments of consideration for the supply of commercial accommodation. The liability to account for VAT in these cases will therefore be triggered at the time that any invoice is issued in respect of the full or part-payment of the consideration, or when the full payment or any part thereof is received.

Deposits are usually not subject upfront to VAT in two different situations,<sup>57</sup> namely:

- Transactions which are generally not intended to lead to a taxable supply. For example, if a hotel charges a key deposit, the understanding is that the guest will use the key during the time that he/she is a guest at the establishment, and upon checking out and returning the key, the deposit will be refunded. Only if the guest fails to return the key will the deposit be simultaneously forfeited and treated as being consideration for a taxable supply.
- When the deposit is lodged with the supplier for a supply which will take place in the future, but gives the person paying the deposit the option to withdraw from the contract at no further cost, other than the forfeiture of all, or part, of the deposit.

In summary, although it may appear to the guest or the accommodation establishment that the prepayment (the so-called “deposit”) is only set-off and applied by the accommodation establishment as consideration against the amount owing by the guest when checking into the establishment, or at the end of the stay, in many cases this is not the case. It is therefore important for the accommodation establishment to determine whether a particular receipt is a prepayment of part or all of the consideration for the supply of commercial accommodation, or whether the amount constitutes a security deposit, which is usually a refundable amount. VAT is only paid on a security deposit at the time that any part thereof is actually applied as consideration for a taxable supply, or if the amount is forfeited and regarded as payment for a taxable supply of services.

#### **Example 17 – Time of supply: deposit vs consideration for a taxable supply**

##### *Scenario*

Hotel Z accounts for VAT on a monthly basis. On 30 December 2008, a guest pays a R500 “deposit” to the hotel in respect of a booking for accommodation starting on 5 January 2009 and ending on 15 January 2009. The hotel does not issue an invoice in respect of the deposit payment, but includes it on the invoice issued at the end of the guest's stay. The invoice reflects the “deposit” amount set-off against the total amount of the hotel bill being R1 500 (including VAT) and the guest pays the balance of R1 000 upon departure. Hotel Z is registered under Category C tax period (monthly).

##### *Question*

When must Hotel Z account for the VAT on the R1 500 charged for the accommodation?

*Continued overleaf ...*

<sup>57</sup> In these examples, the deposits are refundable “security deposits” and the only reason why they are not taxable at the time the payments are made, is because at that particular point in time, they do not constitute consideration for a taxable supply of goods or services. However, these amounts may later become taxable if applied as consideration for a taxable supply, or if forfeited.

**Example 17 (continued)***Answer*

The contractual terms and conditions under which the payment of R500 is made, as well as the accounting and legal characterisation of that receipt will determine whether VAT must be paid at the time of the receipt, or at the time that the amount is set-off against the consideration payable at the time of booking into the accommodation establishment, or upon departure.

In this example, if the amount is characterised as a refundable security deposit, VAT will only be accounted for on the R500 deposit in the January 2009 tax period, because this is when the amount is applied as consideration. But if the amount is recognised for accounting purposes as a prepayment of the consideration which immediately reduces the original obligation of R1 500 by R500, VAT must be accounted for in the December 2008 tax period as follows:

- If registered on the invoice basis of accounting, Hotel Z must account for VAT on the full consideration of R1 500 since the prepayment or part payment of the consideration will trigger the time of supply for the commercial accommodation.<sup>58</sup>
- If registered on the payments basis of accounting, Hotel Z must account for VAT on the part payment of R500.

**7.2.3 Payment through agents**

The intercession of an agent does not affect the time of the supply of accommodation. Two situations which may be encountered where payment for the accommodation is made via a travel agent are discussed below.

*Invoicing of travel agent by accommodation establishment*

After completion of a guest's stay, the accommodation establishment may submit an invoice to the travel agent in respect of the accommodation. The travel agent recovers the full amount from the guest and settles with the accommodation establishment net of any commission. The time of the supply of the accommodation is the date upon which the accommodation establishment issues its invoice, as this date usually precedes the date of payment. The time of the supply of the travel agent's services will usually be the date on which the agent settles with the accommodation establishment, as payment of the commission has taken place on that date by way of set-off. Where the travel agent issues a document, for example, a commission statement or remittance advice notifying the accommodation establishment of the commission due, before the date of settlement with the accommodation establishment, the time of supply will take place on the date of issue of the relevant document.

*Invoicing of guest by travel agent*

Before the guest's stay, the travel agent may invoice the guest in respect of the accommodation. This will often occur in the context of tour package arrangements. The travel agent will usually remit the amount due to the accommodation establishment in respect of the accommodation net of any commission.

If the travel agent acts as an agent of the accommodation establishment, the issue of an invoice to the guest by the travel agent or the receipt of the guest's payment by the travel agent determines the time of the supply for the supply of accommodation by the accommodation establishment. The time of the supply of the travel agent's services will usually be the date on which the travel agent remits the guest's payment to the accommodation establishment. Where the travel agent deducts the commission and remits the net amount to the accommodation establishment, payment for the travel agent's services takes place by way of set-off.

<sup>58</sup> The accommodation establishment should ensure that it does not account for the consideration again in the January 2009 tax period when it issues the invoice or the tax invoice for the supply.

The time of supply for the travel agent to account for the commission in this case will be the date that the payment has been set-off, as this constitutes payment of the consideration for the supply.

#### 7.2.4 Coupons and vouchers

Hotels and hotel chains may issue a variety of coupons or vouchers to guests or prospective guests. Two different types of coupons or vouchers may be distinguished.

The first type entitles the bearer to receive goods or services to the extent of a monetary value stated on the face of the coupon or voucher. The issuing of these coupons or vouchers does not attract VAT as they are used as an alternative to cash as a payment mechanism. The time of supply of the goods or services is determined by applying the time of supply rule applicable for that specific type of supply.<sup>59</sup> The redemption of the voucher constitutes payment by the bearer.

The second type entitles the bearer to receive goods or services specified on the voucher. In the context of hotels and hotel chains, the coupons and vouchers are often used to permit guests to stay at various hotels at different locations for a predetermined number of days. The guest usually pays in advance for the voucher or coupon and the invoicing or payment in respect thereof determines the time of the supply of the specified goods or services. The redemption of a voucher by the guest does not give rise to any further VAT implications. The principles described in **paragraph 7.2.3** apply equally where payment for the coupons or vouchers takes place through travel agents or other intermediaries.

### 7.3 VALUE OF SUPPLY

#### 7.3.1 General rules

VAT is charged on the value of a supply. In simple terms the value of a supply is the price of the goods or services before adding the VAT which must be charged by the supplier. The VAT must be calculated by multiplying the price by the applicable rate of VAT. Usually the standard rate of VAT (currently 14%) applies in respect of the supply of accommodation and domestic goods and services, although there are a few exceptions. For example, accommodation provided as part of an international journey on ships and trains will be subject to VAT at the zero rate.

The circumstances under which supplies of accommodation are not taxable are discussed in **paragraphs 6.1.2 to 6.1.6**.

#### 7.3.2 Special rules – accommodation establishments

*Refer to **paragraph 6.3**.*

#### 7.3.3 Complimentary accommodation

Where a vendor supplies commercial accommodation for no consideration as part of a promotion of the taxable supplies of the accommodation establishment, the value of the supply is deemed to be nil and no VAT must be levied or accounted for by the relevant establishment.

This rule will, however, not apply where the accommodation is supplied to a connected person in relation to the supplier in a situation where the recipient would not be entitled to claim the full input tax credit, had the open market value been charged.<sup>60</sup> In these cases, VAT must be accounted for by the supplier on the open market value of the supply which is the price usually charged for that accommodation.

---

<sup>59</sup> Usually the general time of supply rule will apply being the earlier of the time that an invoice is issued, or the time that payment is received by the supplier.

<sup>60</sup> Refer to section 10(4) of the VAT Act.

## CHAPTER 8

### RESTAURANTS AND CATERING BUSINESSES

#### 8.1 INTRODUCTION

For the purposes of this chapter, the term “catering” means the business of supplying food and drink which have been prepared for consumption at social or business events. This chapter deals with the VAT implications of supplies made by catering businesses in different circumstances, for example –

- at restaurants and workplace canteens;
- at take-away shops;
- at wedding receptions, parties, business functions, sporting events, exhibitions and conferences;
- at schools, universities and other institutions which supply training and education;
- at hospitals, clinics, nursing homes and other medical facilities;
- on various modes of transport such as aircraft, ships, trains and buses.

Catering, in general, is not subject to any special provisions such as zero-rating or exemption. However, certain supplies of catering may be zero-rated or exempt by reason of the location of the supplies or the type of enterprise and circumstances under which the supplies are made. (*Refer to **Chapter 4** for more details, as well as detailed discussion on the general rules applicable for supplies of entertainment.*)

#### 8.2 AGENTS AND PRINCIPALS

Caterers may either supply meals and drinks for their own account or as agents for another person or entity, called the "principal". It is important, in any given situation, to determine in which capacity a caterer is acting in order to determine the correct VAT consequences of his transactions. (*Refer also to **Chapter 3** for more details on agents and principals.*)

The situations usually encountered are:

- (a) *Caterer acts as a principal* – The caterer purchases food and ingredients, prepares the ingredients for consumption, and sells the prepared food and refreshments either to a single client or to a number of persons attending a function or gathering.
- (b) *Outsourcing of the catering function* – The caterer acts as the principal for the purposes of the supply and takes over the entire responsibility of the client for all aspects involved in making the supplies of food or other refreshments to guests or customers. The client who outsources the function will pay the caterer a service fee for taking on the function.
- (c) *Catering contractor acts as an agent* – The caterer purchases food and ingredients for the account of the client (the principal), prepares the food or other refreshments for consumption and serves the prepared food on behalf of the client to a number of persons attending a function or gathering.
- (d) *Catering contractor acts in a dual capacity* – The caterer purchases food and ingredients for his own account, prepares the food or other refreshments for consumption and sells the prepared food or other refreshments to his client. To this extent the caterer is acting as a principal. However, if the caterer serves the food or other refreshments to guests attending a function or gathering, or sells that entertainment on behalf of the client, the caterer will act as agent.

The VAT implications of these situations are discussed in **paragraphs 8.4 and 8.5**.

### 8.3 RESTAURANTS, TAKE-AWAYS AND FRANCHISES

The supply of prepared food and drink by restaurants and take-aways is subject to VAT at the standard rate. The VAT borne by the owner of the restaurant or shop in respect of the purchase of food, drink and other supplies for the business will constitute deductible input tax.

The supply of food and drink by the restaurateur or shopkeeper to employees for no consideration is dealt with in **paragraph 6.4.2**. Supplies of food and drink to third parties at reduced prices, for example, during a promotion, are subject to the general value of supply rule and accordingly are subject to VAT at the standard rate on the reduced price. Similarly, where a customer redeems a discount voucher as payment or part payment for a meal, VAT is levied on only so much of the price that is not covered by the amount of the discount voucher. The issue of a discount voucher for no charge gives rise to no VAT liability.

Restaurants, take-aways and fast-food franchises will pay VAT on purchases of food, drink and other supplies for the business. This could include purchases of liquor, condiments, crockery, cutlery and furniture. VAT will also be paid by the caterer on expenditure such as the rental of business premises and on advertising. This VAT will usually qualify as input tax and as such will be fully deductible against output tax.

Many restaurants and fast-food outlets are operated on a franchise basis. An initial fee is paid by the franchisee to the franchisor in order to acquire the franchise, while a regular payment is made by the franchisee to the franchisor which is usually a monthly amount based on the franchisee's turnover. The franchisor must levy output tax both on the initial fee and on each franchise payment thereafter. The franchisee will therefore incur VAT both on the initial fee and on the subsequent franchise payments. The VAT paid on the franchise payments may be recovered as input tax provided that the franchisee is in possession of valid tax invoices in respect of the transactions.

### 8.4 CATERING IN FACTORIES, OFFICES AND OTHER WORKPLACES

#### 8.4.1 Catering provided by the organisation itself

Any person or organisation running its own staff canteen is acting as a principal. The VAT treatment of the canteen operation will depend largely on whether the prices charged to patrons or employees cover the costs of supplying the meals and beverages as well as the operating costs of the canteen.

If the prices charged cover the direct and indirect costs, the operator of the canteen is regarded as being in the business of supplying entertainment and VAT must be charged at the standard rate on the price of any meals or drinks supplied. In these circumstances, any VAT incurred on the acquisition of any goods and services for the purpose of supplying the food and beverages will qualify as input tax and may be claimed by the vendor. The direct costs of running the canteen and supplying the food and beverages include the raw materials, ingredients and salaries of the canteen staff. Indirect costs include electricity, water and other overheads as well as an appropriate portion of the cost of fridges, ovens and other equipment. (Refer to **Chapter 4 – Example 5**.)

If no price is charged, or if the prices charged do not cover the direct and indirect costs (for example, if the staff canteen is subsidised by the employer), the charges for meals and beverages is deemed to be nil<sup>61</sup> and the employer (principal) does not declare any output tax. In these cases, the supply of food and beverages is treated as a supply by a person not being in the business of supplying entertainment. Any VAT incurred on the acquisition of goods or services for the canteen may therefore not be deducted as input tax as contemplated in proviso (i) to section 17(2)(a)(i).

---

<sup>61</sup> Section 10(21).

The denial of an input tax credit in these situations applies to food and other ingredients, kitchen equipment and utensils as well as furniture and fittings and other expenses which are directly or indirectly related to the supply of entertainment by the canteen operation.

#### **8.4.2 Outsourcing of the catering function**

A catering contractor that operates catering facilities on someone else's premises as a principal is usually considered to be in the business of supplying entertainment. Therefore, if the catering contractor charges a price which exceeds the direct and indirect costs of supplying the entertainment, the VAT incurred on the acquisition of any goods or services acquired in order to provide the meals will qualify as input tax in the hands of the catering contractor.

VAT should be levied at the standard rate by the contractor on –

- any charges made to patrons for the supply of meals or beverages;
- any fee charged to the employer for the service of supplying the meals and beverages to employees;
- any other amounts received from the employer in respect of services provided by the caterer, or as a subsidy in respect of employee meals.

The employer who is usually (but not always) the owner of the catering facilities, will generally not be able to claim input tax on the goods and services supplied by the catering contractor or any payment to subsidise employee meals, since the employer in these circumstances is not in the business of supplying entertainment (catering).

Any charges by the employer to the caterer for using the catering facilities or premises (for example rent, water and electricity) will attract VAT at the standard rate according to normal VAT principles if the employer is a vendor. The caterer (if registered as a vendor) will be entitled to claim the VAT so charged as input tax, subject to the usual documentary requirements.

#### **8.4.3 Catering provided by an agent**

A catering contractor that operates canteen facilities as an agent on behalf of the employer does not supply the meals and beverages provided in the canteen and is not responsible to account for the input tax and output tax in that regard. The employer (principal) in such circumstances is responsible to account for any VAT on supplies made by the canteen and may claim input tax on any food or other ingredients purchased by the caterer on behalf of the principal to provide the meals or beverages served in the canteen, as those purchases are for the account of the principal.

Any fees charged by the catering contractor to the principal in respect of the agent's services of arranging and overseeing or managing the catering function will attract VAT at the standard rate if the catering contractor is a vendor.

Whether the owner of the catering facilities will be entitled to claim an input tax deduction on any VAT on the catering contractor's fees or on any other entertainment expenses incurred in order to provide the canteen facilities will depend on the circumstances of the particular case. If a price is charged by the employer (principal), which is sufficient to cover the direct and indirect costs of making the supply of entertainment, input tax may be claimed on any VAT so incurred. The price charged would of course in these circumstances include VAT at the standard rate. If the costs are not covered by the price charged, no VAT is levied on the supply of the meals and beverages and no input tax may be claimed on the food, ingredients, catering contractor's fees and other costs associated with providing the canteen facility.



#### 8.4.4 Caterers acting in a dual capacity

In cases where the catering contractor supplies the prepared food and drink to the employer and also agrees to serve the users of the canteen on the owner's behalf, the catering contractor is acting in a dual capacity. The caterer acts as principal in purchasing the ingredients and preparing the meals and other refreshments for sale to the client (employer), but also acts as the agent in serving or perhaps selling the meals and other refreshments on behalf of the employer (principal).

The catering contractor should levy VAT at the standard rate on any charge to the principal for preparing or serving the food and beverages to staff or other customers, or for managing the catering function on behalf of the principal.

Assuming that the catering contractor is in the business of supplying entertainment and charges a price to the employer which exceeds the direct and indirect costs of supplying the entertainment, the catering contractor will be entitled to deduct as input tax any VAT incurred on the acquisition of the food and other ingredients.

The VAT treatment of the employer (principal), who is the supplier of the meals and beverages to employees, will in turn depend on whether the prices charged covers the employer's direct and indirect costs of supplying the meals. (*Refer to **paragraph 8.4.1.***) In this situation, the catering contractor's agency or management fees relating to the operation of the canteen facility must be taken into account as a direct cost for the purposes of determining whether the direct and indirect costs are covered.

### 8.5 CATERING IN EXEMPT EDUCATIONAL INSTITUTIONS<sup>62</sup>

#### 8.5.1 Catering provided by the organisation itself

Any educational institution which runs its own catering facility is acting as a principal. The supply of food and beverages by the catering division of the educational institution is exempt from VAT where the food and beverages are supplied mainly for the benefit of pupils or students of the educational institution where the charge for those supplies is included in the tuition fee charged for the exempt education.

If the catering facility operates as an independent branch or division of the educational institution so that prices are charged separately from any tuition fees, the principles described in **paragraph 8.4.1** will apply. This will also be the case where the institution supplies education or training which is not exempt.<sup>63</sup> In these cases, the educational institution will usually be liable to register for VAT, but the liability for registration and the VAT treatment of supplies made by the educational institution from the canteen operation will depend on whether the prices charged are sufficient to cover all the direct and indirect costs of operating the canteen.

#### 8.5.2 Outsourcing of the catering function

As mentioned in **paragraph 8.4.2**, if a catering contractor operates on someone else's premises as a principal, the catering contractor is usually considered to be in the business of supplying entertainment. Therefore, if the catering contractor charges a price which exceeds the direct and indirect costs of supplying the entertainment, the VAT incurred on the acquisition of any goods or services acquired by the catering contractor in order to provide the meals will qualify as input tax.

The VAT treatment of supplies made in these circumstances will therefore be the same as discussed in **paragraph 8.4.2**.

---

<sup>62</sup> This rule does not apply to public schools. *Refer to footnote 38.*

<sup>63</sup> Education and training which does not fall within the educational services contemplated in section 12(h).

### 8.5.3 Catering provided by an agent

The VAT treatment of supplies made in these circumstances will be the same as discussed in **paragraph 8.4.3** in regard to catering in factories, offices and other workplaces. However, an exception is that the supply of food and beverages by an educational institution will be exempt from VAT if the food and beverages supplied are for the benefit of pupils or students of the educational institution and the charge for those supplies is included in the tuition fee charged for the exempt education. In such a case, the educational institution will not be able to claim input tax on the goods and services supplied by the catering contractor, as the supply of the entertainment (food and beverages) is incidental to the supply of the exempt education.

### 8.5.4 Caterers acting in a dual capacity

The VAT treatment of supplies made in these circumstances will be the same as discussed in **paragraph 8.4.3** in regard to catering in factories, offices and other workplaces and in **paragraph 8.5.3** above.

## 8.6 CATERING IN HOSPITALS AND OTHER MEDICAL FACILITIES

Supplies made in hospitals, clinics, nursing homes or other medical facilities operated by the provincial government fall outside of the VAT system. Therefore any supplies of entertainment or medical services to patients in these circumstances will not attract VAT. As government is generally not permitted to register as a vendor, the VAT incurred on any goods or services acquired in order to provide meals and beverages to patients in these circumstances is a cost to the institution. The institution will therefore have to factor the VAT cost of acquiring any goods or services (including entertainment) into the prices charged for the supplies made to patients, taking into account any amount which may be received from government to subsidise those supplies.

In the case of hospitals, clinics, nursing homes or other medical facilities operated by a person other than the provincial government (for example, private companies or municipalities), any supplies of entertainment or medical services to patients will be taxable at the standard rate and the corresponding principles according to the scenarios described in **paragraphs 8.4 and 8.5** above will apply.

## 8.7 CATERING ON SHIPS AND AIRCRAFT

In most cases, the price of the ticket for passage on a ship or a flight on an aircraft will include certain meals and refreshments, and in some cases, it will also include other on-board entertainment during the course of the journey.

In these cases, the VAT treatment of the supplies follows the VAT treatment of the transport service so that –

- if the transport is within the Republic, the transport service will be subject to VAT at the standard rate, as will the meals, refreshments or other entertainment provided on board that transport; and
- if the ship or aircraft is on an international journey (that is, from a place situated in the Republic to a place outside the Republic (or *vice versa*) or between two places outside the Republic), the transportation service is subject to VAT at the zero rate, as will the meals, refreshments or other entertainment provided on board that transport.

Similarly, the separate supply of any food, beverages, and other refreshments or entertainment by the operator of the ship or aircraft during the course of a flight or voyage which is not included in the ticket price will be subject to VAT at the standard rate if the transport takes place within the Republic and will be zero-rated if supplied during the course of an international voyage.

The supply of prepared meals, and other food or beverages to an operator of a foreign going ship or foreign going aircraft is subject to VAT at the zero rate if that ship or aircraft is going to a destination in an export country and the food and beverages are for consumption by the crew and passengers. A ship or aircraft is considered to be foreign-going if –

- the ship or aircraft is engaged in the transportation for reward of passengers or goods wholly or mainly between ports or airports in the Republic and ports or airports in export countries, or
- the ship or aircraft is registered in an export country and is used primarily in an enterprise conducted outside the Republic by a person who is not a vendor and not a resident of the Republic.

The owner or operator of a ship or aircraft is entitled to deduct as input tax any VAT incurred on meals, food or beverages acquired in order to provide meals or refreshments during the journey in conjunction with the taxable transport service, provided that the price charged is sufficient to cover the costs of the transport as well as the meals and beverages.

## **8.8 CATERING ON TRAINS AND BUSES**

Public transport on buses and trains within the Republic is exempt from VAT, whereas international transportation on buses and trains is subject to VAT at the zero rate. The VAT treatment of supplies of meals and beverages by the operator of a train or bus will therefore depend upon whether the operator makes taxable supplies in the form of international transportation or not.

If international transportation is provided, the vendor must cover the direct and indirect costs of supplying the meals or beverages as part of the price charged for the international transportation to be entitled to claim an input tax deduction for any goods or services acquired in that regard. The supply of meals and beverages in this case is also zero-rated where there is a single composite charge for the transport and the meals.

Where there is a single composite charge by way of a single ticket for the supply of the exempt transportation services within the Republic which includes meals, refreshments, beverages, or other entertainment, the supply of this entertainment is regarded as being part of the supply of the transport and therefore receives the same VAT treatment as the transport.

However, if meals, beverages or other entertainment are supplied separately during the course of the transport, the sales will be subject to VAT at the standard rate if they take place within the borders of the Republic and zero-rated if supplied outside the borders of the Republic. A deduction of input tax may be made by the operator in this regard, provided that the price charged is sufficient to cover the costs of supplying that entertainment.

Supplies of catering services, prepared meals or other food and beverages by a catering contractor to the owner or operator of a bus or train will be subject to VAT at the standard rate. Whether or not the operator will be entitled to deduct an input tax credit in respect of the acquisition of the meals and beverages will depend on whether the transport operator uses the meals and beverages for taxable or exempt supplies.

## **8.9 CATERING AT SEMINARS AND OTHER EVENTS**

VAT must be levied at the standard rate on any fee charged to participants of a seminar or similar event. Where the fee charged for participation includes the provision of meals and beverages by the organiser to participants during the course of the seminar or convention and this fee covers the cost of providing the meals and refreshments, the organiser will be entitled to deduct any VAT incurred on goods or services acquired in order to provide those meals and refreshments as input tax.

Where meals, beverages or other refreshments are supplied to participants of the seminar by the organiser for a charge which is separate to the fee for the seminar, the VAT treatment will differ according to whether or not the costs of the meals or refreshments are covered by the price charged by the organiser for the meals and refreshments.

Where the costs are not fully covered or the refreshments are supplied for no consideration, VAT is not levied by the organiser on the supply of the refreshments. The organiser will, in these circumstances, not be entitled to claim an input tax deduction in respect of the VAT incurred on the acquisition of any goods or services acquired to provide the refreshments.

Where the costs are covered by the price charged, VAT is levied at the standard rate on the supply. In these circumstances the organiser will be entitled to deduct input tax in respect of the VAT incurred on the acquisition of the goods and services acquired in order to provide the refreshments.

Supplies of catering services, prepared meals or other food and beverages by a catering contractor to the organiser of a convention or seminar will be subject to VAT at the standard rate. Whether or not the organiser will be entitled to deduct input tax on the acquisition of the meals and beverages will depend on the particular circumstances of the organiser as dealt with above.

### **8.10 OTHER SUPPLIES OF CATERING**

The VAT implications for caterers in circumstances not addressed thus far will depend on the capacity in which the catering contractor is acting. The principles described in **paragraphs 8.4 and 8.5** pertaining to catering contractors will apply to most catering situations.

The VAT implications for the catering contractor's client will differ depending on the circumstances of each particular supply. Where catering services are provided to private individuals not registered for VAT (for example, at weddings or parties), any VAT charged by the caterer will have to be borne by the client as an integral cost of holding the event. Similarly, when catering services are provided to vendors to enable them to entertain clients, customers or associates, the VAT charged by the caterer will usually not be deductible as input tax and forms a part of the cost of holding the event unless a consideration is charged for the provision of the food, refreshments or beverages to the guests which covers the cost of making those supplies.

## CHAPTER 9

### CLUBS, ASSOCIATIONS AND SIMILAR BODIES

#### 9.1 ASSOCIATIONS NOT FOR GAIN AND WELFARE ORGANISATIONS

An association not for gain means any religious institution, society or organisation, including an educational institution of a public character, which is carried on otherwise than for profit and in terms of its written constitution, amongst other things, is required to use any property or income solely in the furtherance of its aims. (Refer to the **Glossary**.)

Many clubs, associations or societies which supply entertainment will therefore fall within the definition of an "association not for gain" for VAT purposes and could include –

- societies, for example, those formed for the promotion of culture and arts;
- charities;
- sports and recreational clubs; and
- public-interest groups.

To the extent that an association not for gain carries on business activities, the normal "enterprise" rules apply.<sup>64</sup> However, the benefit of qualifying as an association not for gain is that the VAT Act contains provisions specifically designed to benefit an association not for gain. For example, no output tax is declared on donations received, grants from the State or a municipality are generally subject to VAT at the zero rate, and the importation of certain donated goods into the Republic is exempt from VAT.

An association not for gain (unlike a welfare organisation) must charge a consideration for the supply of goods or services and must have exceeded the minimum threshold of in excess of R20 000 in the past 12-month period (or R60 000 in the case of supplies of commercial accommodation) to qualify for voluntary VAT registration.

A welfare organisation is a special type of association not for gain that has two additional benefits under the VAT system, namely –

- the minimum threshold for voluntary registration does not apply, as a welfare organisation is not required to supply goods or services for a consideration to qualify for voluntary VAT registration; and
- input tax may be claimed on certain entertainment expenses which are usually disallowed for other vendors.

To qualify as a "welfare organisation" for VAT purposes, the organisation must be a public benefit organisation that has been approved by SARS for income tax purposes and must carry on certain welfare activities, as determined by the Minister of Finance in Regulation 12 of 2005. However, a welfare organisation's overall enterprise activities are not limited to the listed welfare activities and like any other association not for gain, to the extent that it conducts business activities, the normal "enterprise" rules will apply.

*For further information relating to public benefit organisations, associations not for gain and welfare organisations, refer to the Tax Exemption Guide for Public Benefit Organisations in South Africa, and the VAT 414 – Guide on Associations not for Gain and Welfare Organisations which are both available on the SARS website.*

---

<sup>64</sup> This does not apply if the association not for gain is a public school. Refer to **footnote 38**.

## 9.2 DONATIONS, MEMBERSHIP FEES AND ENTRANCE FEES

The provision of membership benefits or entertainment by any club, association, society or other body of a sporting, cultural, political, religious, philanthropic or philosophical nature in return for the payment of a consideration constitutes the carrying on of an enterprise. The function, purpose or legal form of the organisation is irrelevant in determining whether the supplies which it makes, attract VAT or not.

Any entrance fees, admissions charged or subscriptions received will therefore be subject to VAT at the standard rate if the organisation is a vendor, or if it is liable to register for VAT. For VAT purposes, no distinction is made between membership subscriptions paid by local members (residents) and those paid by non-residents, because in both cases the services are regarded as being consumed in the Republic.

Subscriptions (membership fees) paid to clubs, associations or societies are sometimes described as donations, but this is usually not the case. This is because to qualify as a donation, the payment must –

- be entirely voluntary;
- secure nothing of value for the donor in return (including membership of the organisation); and
- be entirely at the discretion of the donor as regards the amount, timing and regularity.

Associations not for gain and welfare organisations often receive donations and will not declare output tax on those receipts as they will generally not constitute consideration received from the donor in respect of a supply of goods or services. However, for a payment to be accepted as a donation it must be clear to both the donor and the donee that entrance into an event, or any other supply of goods or services, is not conditional upon any payment. In other words, the payment must be totally at the discretion of the donor and must not be a prerequisite for the supply to be effected.

If a person has to pay an entrance fee, or is made to think that payment is a requirement to gain entry to an event or for the supply of other goods or services; the payment will not constitute a donation, but an admission charge or other consideration which is subject to VAT at the standard rate. For example, where a "free will" collection is taken inside a concert hall or sports ground, this may under certain conditions amount to a donation and not an admission charge. The conditions are that the person receiving the benefit of the payment is an association not for gain and that the payment constitutes a "*donation*".

*For further information regarding donations, refer to the VAT 414 – Guide for Associations not for Gain and Welfare Organisations.*

The general time of supply rule is applicable to any membership benefits supplied by clubs, associations, societies and similar bodies. Therefore, such supplies are deemed to take place when an invoice is issued or any payment is received, whichever is the earlier. The tax period in which the liability arises to account for VAT on membership fees will therefore depend on the facts of the case.

**Example 18 – Time of supply: Membership subscriptions***Scenario*

Club A and Club B are both sports clubs. Club A issues renewal notices in December 2008 for membership fees due in respect of the 2009 calendar year. The renewal notice takes the form of an invoice and indicates to the member that an obligation to make payment for the 2009 membership fees already exists. Club A usually receives payment from all members by the end of February each year.

Club B sends notices in December 2008 to existing members requesting written confirmation on an attached response slip that the person commits to be a member in the 2009 calendar year. Once the response slips are received, Club B issues the person with an invoice. If payment is received without a response slip, or together with the response slip, a tax invoice is issued.

*Question*

What are the VAT implications for Club A and Club B?

*Answer*

*Club A* - The issuing of the renewal notices constitutes the issuing of invoices and therefore triggers the time of supply for membership fees in December 2008 since an obligation to make payment has already arisen. Club A must therefore account for the VAT on the membership fees in the tax period covering December 2008. If Club A is registered on the payments basis, it will only account for VAT to the extent that the membership payments are actually received.

*Club B* - The notice issued in December 2008 for the purpose of obtaining written confirmation for membership in the 2009 calendar year does not constitute an invoice. Therefore Club B has no obligation in December 2008 to account for VAT on membership fees for the 2009 calendar year. Only once Club B issues invoices to members who have confirmed their membership or made payment for membership for 2009 will Club B be liable to account for the VAT on the membership fees. Alternatively, if Club B is registered on the payments basis, it will only account for VAT to the extent that the membership payments are actually received.

Any entrance fee or admission charged may cover a single event or a series of events and any fee for the supply of the right of admission to any function or event which takes place in the Republic is subject to VAT at the standard rate. The price of a ticket for admission to any event, or series of events which take place outside of the Republic will be subject to VAT at the zero rate. For example, if a person purchases a ticket to attend a rugby match which takes place in the Republic, VAT must be charged at the standard rate. However, if the match takes place in Australia or New Zealand, the ticket price to attend the match will be subject to VAT at the zero rate.

If a person has to buy a programme to get into a sporting event, concert or other entertainment, the payment for the programme is the consideration for the admission.

Examples of events where VAT must be charged on admissions or entrance fees include –

- cinemas, theatres and other places of entertainment;
- amusement arcades and funfairs;
- discotheques and dances;
- horse racing meetings and other sports events;
- botanical gardens; and
- zoo's and game reserves.

The general time of supply rule is applicable to admissions so that the supply is deemed to take place when an invoice is issued or any payment is received, whichever is the earlier. As invoices are not usually issued in respect of admissions, payment of the admission, or part thereof, will usually determine in which tax period the supply takes place. Where tickets, tokens, vouchers or programmes are issued on payment of the admission charge which entitles the bearer to admittance to the premises, function or event, the payment in respect thereof will determine the tax period in which the supply of admission is made. The time of supply of admissions to a series of events, for example, where a season ticket is issued, will take place on payment or part payment for the season ticket.

The general value of supply rules apply to admissions, so that VAT is levied at the standard rate on the price of the admission before the addition of VAT. Alternatively, the amount of VAT charged may be calculated by applying the tax fraction (14/114) to the VAT-inclusive price of admission.

### 9.3 OTHER CHARGES FOR GOODS AND SERVICES

Subject to the general rules that require supplies of entertainment to be made for a consideration which covers all direct and indirect costs (*refer to paragraphs 4.2 and 4.3*), all other types of supplies of entertainment will be subject to VAT at the standard rate if the club, association or similar organisation is a vendor.

Examples include –

- supplies of prepared food and beverages such as bar sales, catering at sports events and club social functions;
- charges for participating in sports and games such as court fees, squash court and snooker table light meters, green fees, entrance fees, gaming machines and gambling tables; and
- any fee payable to enter any competition or to participate in a betting transaction or any other game of chance.

*Refer to **Chapter 10** for more details on the VAT treatment of supplies made by associations not for gain which are sports clubs.*



## CHAPTER 10

### ENTERTAINERS AND SPORTSPERSONS

#### 10.1 INTRODUCTION

The main difference between the way that entertainers and sportspersons ply their trade is that the work of sportspersons usually takes place within the environment of local or international competitions, where prizes and awards are at stake. This is less so for entertainers, and although there are also a number of other differences between the way that entertainers and sportspersons exercise their calling, they are for VAT purposes treated in a similar manner.

For example, an entertainer may be employed by the owner of an entertainment venue or a theatrical production company where the entertainer carries on work as a performer, just like any other employee of a business. Similarly, with team sports such as soccer, rugby and cricket, a sportsperson may be an employee of a club, players' association, team franchise, or provincial or national sports body, and be remunerated for playing sport in accordance with an employment contract.

Alternatively, the entertainer or sportsperson may render services in his/her capacity as an "independent contractor" to owners of entertainment venues, sports clubs, event promoters, or through an agent. An entertainer or sportsperson may also act independently and promote his/her own event.

In each case, the contractual relationships between the various parties will determine the VAT treatment of the entertainer or sportsperson's services. (*Refer also to **Chapter 3.***) It follows that although the trading environment of entertainers and sportspersons may have some unique features, for the most part, the application of business (enterprise) principles and the VAT law will be the same for entertainers and sportspersons as it is for any other enterprise.

#### 10.2 AGENTS

Theatrical and sports agents usually act as agents in the strict sense of the word by introducing the services of artists, sportspersons or other entertainers to employers<sup>65</sup> such as a sports clubs, event promoters or venue owners, in return for a commission or fee. The service of introducing entertainers or sportspersons to an employer or potential employer is subject to VAT at the standard rate, whether the commission or fee is earned from the entertainer or the employer. The agent should account for output tax only on the commission or fee and not on the total amount charged to the venue by the entertainer. In certain circumstances the theatrical agent may, however, issue a tax invoice on behalf of the entertainer in respect of the entertainer's charge. (*Refer to **Chapters 3 and 7.***)

However, it is also a practice for an entertainer or artist to contract his/her services to a theatrical agent for an agreed period and fee. The theatrical agent subsequently supplies the performance to a promoter, proprietor, or owner of a venue. In this situation the theatrical agent is acting as a principal and not as an agent. The theatrical agent should in these situations levy VAT on the total charge to the promoter, proprietor, or owner of a venue and issue that person with a tax invoice for the supply. To the extent that sportspersons and their agents engage in these same practices, the same principles will apply.

---

<sup>65</sup> The term "employer" is used in its widest possible sense here to include any person who requires the services of the entertainer or sportsperson, whether that person enters into a formal or permanent employment contract, or merely contracts for services to be rendered for a period of time, or for services to be rendered for a once-off event.

### 10.3 EMPLOYEES AND INDEPENDENT CONTRACTORS

Services provided by an employee to an employer within the framework of a formal contract of employment fall outside the scope of VAT and do not amount to the carrying on of an enterprise. Where an employer/employee relationship exists between the entertainer/sportsperson and the person providing the entertainment, no VAT should be levied on the remuneration paid to the employee, whether in the form of a salary, wage, bonus or percentage of entrance fees to the performance. In these situations the employer will be obliged to deduct employees tax (PAYE) from the entertainer's/sportsperson's remuneration.

If the entertainer or sportsperson is not in an employer/employee relationship with the supplier of the entertainment or sporting event, the person acts as an "independent contractor" and any services rendered for a consideration could constitute the carrying on of an enterprise. If the entertainer/sportsperson is registered or liable to be registered<sup>66</sup> for VAT, the services supplied will attract VAT at the standard rate and the normal rules with regard to the issuing of tax invoices and accounting for VAT on taxable supplies will apply. If the entertainer/sportsperson is a vendor and promotes his or her own events, VAT must be levied on any amounts charged to patrons of the event, whether these charges are in the form of admission fees, appearance fees, cover charges or any other amount. This includes any amount which is calculated as a percentage of another amount.<sup>67</sup>

The Common Law Dominant Impression Test Grid (the Test) is applied to determine whether a person is engaged by way of contract for services (employee) or contract of service (independent contractor). The Test makes use of several indicators, all of which must be considered. Furthermore, each case should be examined on its facts, giving particular attention to whether a written contract containing a statement of the purported nature of the contract exists, or where no clear written contract exists, whether one or more contracts, or an "umbrella contract" exists.

At common law, no single indicator is conclusive or a determinant of a person's status. It is important to note that the indicators are divided into three categories (i.e. near conclusive, persuasive and relevant) in establishing whether an employee/employer relationship or an independent contractor/client relationship exists for the purposes of withholding PAYE. The Test is essentially an analytical tool that is designed for application in the employment environment to establish the dependence or independence of a person and may also be used to determine whether a person is independent for VAT purposes. Where a person is an independent contractor in terms of the common law principles, that determination will apply for VAT purposes, notwithstanding the fact that a person might be subject to PAYE.<sup>68</sup>

One of the situations which may arise for entertainers and sportspersons is that they may be employees in one situation and independent contractors in another situation at the same time. For example, a soccer player may be an employee of a soccer franchise, but at the same time, celebrity appearance fees or advertising endorsements may be separate supplies made by that sportsperson outside of the employment contract. Should the receipts for appearance fees and advertising endorsements exceed the compulsory VAT registration threshold, that sportsperson will be required to register and levy VAT on those supplies (excluding any remuneration earned for services provided as an employee of the soccer franchise).

*Refer to **Annexure B** which sets out the elements of the Test as well as the characteristics of an employment contract vs a contract for work.*

---

<sup>66</sup> The general rule is that if an entertainer conducts an enterprise and the value of taxable supplies for any 12-month consecutive period exceeds R1 million or is likely to exceed this amount, the person is obliged to register for VAT. Alternatively, the person may apply to register for VAT voluntarily if the value of taxable supplies in the past 12-month period exceeds or is reasonably expected to exceed the voluntary registration threshold (currently R20 000 but will increase to R50 000 on 1 March 2010).

<sup>67</sup> When consideration is calculated in this manner, to avoid disputes, it is recommended that the contract states clearly as to how the amount shall be calculated. This includes agreement on whether the amount used as a basis for the calculation includes VAT or not, as well as whether the result from that calculation includes VAT or not.

<sup>68</sup> Refer to *Income Tax Interpretation Note: No. 17 (Issue 2) dated: 9 January 2008* for more details.

## 10.4 TRANSFER FEES

In sport, it is an annual occurrence that players are transferred from one club to another. These transfers could be local (within the RSA) or across international borders and are particularly prevalent for soccer, rugby and cricket.

For example, under rules established by *Fédération Internationale de Football Association* (FIFA), a player that is contracted to a club can have his contract sold to another club through a process known as the transfer system. This system requires a club “buying” a player to pay compensation to the club surrendering its player. Simply put, a transfer fee is an amount paid by one club to another for the services of a player. Usually the player is also given a percentage of the transfer fee, but this is negotiated between the player and the club giving up the services of the player.

It follows that what is being sold is not the player, but the services of that player. The surrendering or granting of the right by the selling club to the purchasing club is the supply of a service, and accordingly, the amount paid in this regard constitutes consideration for a taxable supply at the standard rate if the club surrendering the services of the player is a vendor. These services, when supplied to a foreign club which is not a resident of the Republic and not a vendor, will be subject to VAT at zero rate. As the player in a team sport such as soccer will usually be an employee, any amount paid to the player by the club which surrenders the services of the player will constitute remuneration and will not include any VAT.

The same principles will apply to the extent that contracts in other sporting disciplines or in the entertainment industry are entered into or terminated in a similar manner.

## 10.5 INTELLECTUAL PROPERTY

Any amounts earned by entertainers and sportspersons for supplying the right of use of intellectual property in the form of royalties, patents, trademarks, copyright, broadcasting rights, etc are subject to VAT at the standard rate. In certain cases the supply of these rights will be subject to VAT at the zero rate to the extent that a fee is paid to use the rights outside of the Republic.

Similarly, where a vendor pays a non-resident a fee to use intellectual property in the Republic, there will be no VAT payable on the fee. However, this is on condition that the non-resident is not liable to register for VAT in the Republic, and further, that the recipient uses the intellectual property wholly for the purpose of making taxable supplies in the Republic.<sup>69</sup>

## 10.6 TICKET SALES

The sale of tickets for entry into any sporting or other entertainment event will usually be subject to VAT at the standard rate, but if the event takes place in a stadium or other venue outside of the Republic, the price of the ticket will be subject to VAT at the zero rate.

## 10.7 STADIUMS

Stadiums are usually owned or leased by provincial sporting bodies, sports clubs, municipalities, or property holding entities connected to sporting bodies. These persons make stadium space available either by the sale of hospitality boxes or by the letting of the stadium space or a part thereof to other persons for the purposes of holding a sporting event, theatrical production, cultural or political event, musical show, or for other vendor outlets. In any of these cases the supplies are subject to VAT at the standard rate.<sup>70</sup>

---

<sup>69</sup> If the intellectual property is imported and used wholly or partially for private purposes, exempt supplies, or other non-taxable purposes, VAT must be paid at the standard rate on the importation of those services by the recipient.

<sup>70</sup> Special rules in respect of the letting of trading space at stadiums and certain other areas near stadiums during the 2009 FIFA Confederations Cup™ and the 2010 FIFA World Cup™ competitions are applicable.

Vendors that have bought or leased a hospitality box for the purpose of entertaining directors, employees or clients may not claim input tax thereon, nor on any food or beverages provided, if there is no charge or if the charge does not cover the cost of providing that entertainment. (Refer to **Chapter 4**.)

Another form of income generated from stadiums is the supply of advertising space where advertisers place billboards, banners and other signage advertising their products around the stadium. The supply of this type of advertising space is also subject to VAT at the standard rate. However, in the case of non-resident advertisers that do not carrying on an enterprise in the Republic, the zero rate of VAT applies.<sup>71</sup>

If a public authority, constitutional institution or municipality pays an amount to a municipality or other vendor in the form of a subsidy or grant<sup>72</sup> from public funds for the purpose of erecting a stadium or upgrading the facilities at the stadium to host matches for the 2010 FIFA World Cup™, that receipt is subject to VAT at the zero rate in the hands of the grantee. When the grantee spends the grant funding on building work or other goods and services to build or upgrade the stadium, VAT must be charged at the standard rate and the suppliers must issue tax invoices for the supplies made to the grantee. The grantee (being a vendor) will be entitled to claim the VAT incurred on those expenses as input tax.

## 10.8 REFRESHMENTS PROVIDED TO EVENT PARTICIPANTS

When a sporting organisation or event promoter holds an event, it is usually expected to provide free food and drinks, or to issue meal vouchers to event participants. For example, at a professional sporting event, meals may be provided to players, scorers, umpires, visiting dignitaries, security guards and other employees or staff participating in the event. Further, in some sports it is traditional that visiting sides are provided with meals and accommodation by the home side, and in some cases, the person holding the sporting event is expected to pay for meals and accommodation for visiting dignitaries attending the event.

The VAT on these expenses may be claimed as input tax by the sporting organisation or promoter if the expense was incurred in the ordinary course of hosting the event (which is a supply of “*entertainment*”).

## 10.9 LEVYING OF FINES AND PENALTIES

As a general rule, statutory fines and penalties are not subject to VAT as they do not constitute the payment of consideration for a taxable supply of goods or services by the person imposing the fine or penalty (e.g. a speeding fine issued by a municipality). In other words, there is no underlying supply of goods or services to which the payment of that fine or penalty relates, and therefore, it cannot fall within the ambit of the VAT Act and be taxed (i.e. the receipt is “out of scope” for VAT purposes).

The same reasoning applies for non-statutory fines and penalties levied by associations not for gain such as sports clubs and other membership based organisations. However, in these cases there is sometimes an underlying supply which has been made for a consideration by the person imposing the fine or penalty, to which the fine or penalty could be linked. For example the fine or penalty could be imposed on the member as a means of adjusting the previously agreed consideration for a taxable supply, or it could constitute an additional consideration for a taxable supply, or it could even be a consideration for a separate taxable supply.

---

<sup>71</sup> It is accepted in such cases that the advertising space is not supplied directly in connection with fixed property situated in the Republic, and is subject to VAT at the zero rate, provided that the non-resident is not advertising any products (movable goods) which are situated in the Republic at the time.

<sup>72</sup> A grant is an amount paid to a vendor by a public authority, constitutional institution or municipality for the purpose of subsidizing or supporting the taxable activities of that vendor where it is in the public interest to do so. It is a requirement that the entity making the grant payment does not receive any goods or services from the grantee or recipient in return. Therefore, the amount paid may not constitute consideration for the procurement of goods or services by the person making the payment, otherwise the amount will not constitute a “*grant*” as defined in section 1 of the VAT Act and will not be subject to VAT at the zero rate.

Therefore, a fine or penalty may, or may not be subject to VAT, depending on whether the amount has been paid in respect of, in response to, or as inducement for, the taxable supply of goods or services. The payment will be subject to VAT if it can be linked to the consideration for a taxable supply by the person charging the fine or penalty. No VAT should be charged if there is no link, or if the link is very remote.

As a guideline, there will usually be no supply or any adjustment of the original consideration for a supply (and hence no output tax) when –

- the fine or penalty is imposed by the association on a member because of the member's non-compliant behaviour with the membership rules;
- the fine or penalty is primarily intended as a punishment, or to act as a deterrent;
- upon payment of the fine or penalty the member receives no additional rights, benefits or privileges to which that person was already entitled by virtue of membership of that association, immediately before the imposition of the fine or penalty.

A levy charged by the association as an additional fee or charge, will be taxable (i.e. it will receive the same tax treatment as any other monthly, annual, or once-off subscription, fee, charge, or special levy). However, if the levy/fine/penalty is actually an “interest” charge on an overdue account, the amount constitutes consideration for an exempt supply [sections 12(a) and 2(1)(c)].

## CHAPTER 11

### MISCELLANEOUS ISSUES

#### 11.1 INTRODUCTION

This chapter deals with other issues relevant to the broad topic of entertainment transactions which are either not dealt with in the previous chapters, or where additional information on the topic is useful to clarify the VAT treatment.

#### 11.2 CONFERENCES AND TRADE FAIRS

If a South African vendor arranges a trade fair or conference in South Africa for a foreign organisation which is attended by representatives of foreign businesses, the view is held that, although the majority of work may be done before the arrival of the foreign visitors in South Africa, this work is of a preparatory nature which does not, in itself, constitute a supply of services but culminates in the supply of a service, being the trade fair, for the benefit of the foreign visitors during their visit to South Africa.

Consequently, the supply of any goods or services which are consumed locally by non-residents are not zero rated and a VAT refund may only be obtained on any goods which are physically removed from the Republic by the foreign visitor on departing. If the non-resident is the supplier of the goods and services to participants, the non-resident will be required to register and to levy VAT on those supplies.

The supply of educational services, contemplated in section 12(h)(i) of the VAT Act, that are presented by way of a conference or workshop under the auspices of an educational institution referred to in that provision, are exempt from VAT. The supply of any accommodation to participants in these conferences or workshops will also be exempt if the accommodation facilities concerned are used mainly for the benefit of the students of that educational institution.<sup>73</sup> The same principle will apply where an educational institution accommodates visiting teams and participants in sporting events in student dormitories, rooms or hostels.

#### 11.3 EMPLOYEE HOUSING

The supply of accommodation in a “*dwelling*” by an employer to is exempt from VAT. The supply is also not a fringe benefit for VAT purposes and therefore the employer in these circumstances must not account for output tax on the supply.

In cases where an employer regularly purchases dwellings belonging to employees (for example, where the employees are relocated and therefore have to sell their dwellings) and subsequently sells those dwellings, the employer will be regarded as conducting an enterprise involving the purchase and sale of fixed property. VAT must therefore be levied on the sale of those at the standard rate. This is the case even where the employer, apart from the purchasing and selling of employee dwellings, is solely engaged in making exempt supplies.

#### 11.4 SUBLETTING OF DWELLINGS

When a landlord enters into a lease agreement in terms of which a number of dwellings are leased to a tenant, the supply is exempt from VAT. If the tenant subsequently sublets the individual dwellings to other tenants, the supply is also not be subject to VAT. However, where the tenant sublets the property for any other purposes, other than for use as a dwelling (for example, for use as an office), the supply is subject to VAT at the standard rate.

---

<sup>73</sup> Refer also to **paragraph 6.1.4** for more details in this regard.

## 11.5 SALE OF FURNISHED FLATS

The VAT treatment of the sale of furnished flats will depend on whether the flat was used for taxable or exempt supplies.

The letting of fully furnished and serviced flats is subject to VAT at the standard rate if the owner is registered for VAT purposes as a supplier of commercial accommodation (which includes the supply of domestic goods and services). Consequently the sale of the furnished flat is subject to VAT at the standard rate in this case. However, if the furnished flat was rented as a dwelling, which is an exempt supply, the sale of the flat will not be subject to VAT, but transfer duty will be payable by the purchaser.

## 11.6 PROMOTIONAL GIFTS

Generally, where a vendor acquires various items to use as gifts and promotional items for clients, the vendor will be allowed to claim input tax thereon, even if they are supplied to clients for no consideration. Examples could include things such as diaries, pens, mouse pads, clothing and product samples which are acquired for the purposes of directly or indirectly promoting the taxable supplies of the vendor's enterprise. However, if the nature of the item falls within the ambit of "*entertainment*", input tax is denied if that vendor does not normally supply those items in the ordinary course of the enterprise. For example, items such as wine, chocolates, hampers, tickets to functions, computer games and music CDs. This rule will apply, even if an entertainment item displays the vendor's logo or branding.

Input tax may be claimed on the manufacture or purchase of the free samples or other promotional items if the vendor makes supplies of the entertainment concerned in the ordinary course of an enterprise. For example, where a wine merchant launches a new wine and offers wine tasting or provides free samples of wine to the public, input tax may be claimed on the acquisition of the entertainment (bottles of wine) supplied to clients, or potential new clients in promoting the product. An apportionment of input tax must be made if the distribution of promotional gifts to clients relates to both taxable and exempt supplies made by the vendor.

## 11.7 RECOVERY OF COSTS

Vendors that agree with their clients to be reimbursed for travel or accommodation costs incurred in making a taxable supply must ensure that VAT is included in the final consideration charged by the vendor for the supply. Therefore, if the consideration is split between a charge for the goods or services supplied and a reimbursement of the vendor's costs in making those supplies, VAT must be levied at the standard rate on both components of the consideration.

## 11.8 SUPPLIES BY EDUCATIONAL INSTITUTIONS<sup>74</sup>

In the case of an educational institution which makes mainly exempt supplies also being registered as a vendor for taxable supplies which it makes, it must charge VAT accordingly. Therefore, if it hires out a hall or other facility, the supply is subject to VAT at the standard rate if the educational institution is registered as a vendor.

The supply of just the hall or venue is not, in itself, a supply of "*entertainment*", even if the venue is used by the recipient to hold functions like weddings, seminars and other entertainment events. However, if the educational institution (as principal) supplies the hall as well as the associated entertainment goods and services for the recipient, the educational institution will be supplying "*entertainment*" as defined in the VAT Act.

A similar example of when a supply by an educational institution may be subject to VAT at the standard rate is where it supplies the use of sports fields or sporting and recreational facilities to other event organisers or sports bodies.

---

<sup>74</sup> This does not include public schools. Refer to **footnote 38**.

## 11.9 CATERING FOR FILM PRODUCTION CREW

If a film production company (vendor) shoots an advertisement, television programme or film in the Republic, the question arises as to whether input tax may be claimed on expenses incurred in regard to catering provided for crew members, clients and production staff during the production of the advertisement, television programme or film.

In terms of the general disallowance rule, a vendor is not entitled to claim an input tax deduction in respect of goods or services acquired for the purpose of entertainment. However, this rule does not apply where the goods or services are acquired for making taxable supplies in the ordinary course of an enterprise which continuously or regularly supplies entertainment for a consideration which covers both the direct and indirect cost of the entertainment or the open market value thereof.

In terms of the second proviso to section 17(2)(a) of the VAT Act, a vendor is entitled to claim an input tax deduction where the goods or services are acquired in respect of the personal subsistence of employees or office holders, who, by reason of their duties, are obliged to spend at least one night away from their usual place of residence and usual working-place. Foreign crew members will only be regarded as employees or office holders if an employment contract has been entered into between the parties concerned. The film production company is entitled to claim an input tax deduction in respect of personal subsistence incurred by local crew members who are away from their usual place of residence and their usual working-place whilst involved in the production of a film or making of an advertisement on location.



## GLOSSARY

**Association not for gain** Any religious institution, society or organisation which is carried on, otherwise than for profit and in terms of its written constitution which governs it –

- is required to use any property or income solely in the furtherance of its aims;
- is prohibited to transfer any portion of property or income to any person, except as reasonable remuneration for services provided; and
- is obliged, at its winding-up or liquidation to give or transfer its assets after satisfaction of debts, to another similar society.

It can also be an educational institution of a public character which –

- is carried on not for profit;
- is in terms of its memorandum which governs it required to use any property or income solely in the furtherance of its aims; and
- is prohibited to transfer any portion of property or income to any person, except as reasonable remuneration for services rendered.

A welfare organisation is a type of association not for gain.

**Commercial accommodation**

Lodging, or board and lodging supplied –

- together with domestic goods and services, in any house, flat, apartment, room, hotel, motel, inn, guesthouse, boarding house, residential establishment, holiday accommodation unit, chalet, tent, caravan, camping site, houseboat, or similar establishment;
- in a home for the aged, children, physically, or mentally handicapped persons; and
- in a hospice.

The accommodation must be regularly or systematically supplied and the total annual receipts in respect thereof must exceed (or must reasonably be expected to exceed) R60 000 a year.

A dwelling supplied in terms of an agreement for letting and hiring thereof is not regarded as commercial accommodation.

Also refer to "*domestic goods and services*" below in respect of values.

**Consideration**

This is generally the total amount of money (incl. VAT) received for a supply. For barter transactions where the consideration is not in money, the consideration will be the open market value of goods or services (incl. VAT) received for making the taxable supply. Section 10 determines the value of supply or consideration for VAT purposes for different types of supplies.

Any act of forbearance whether voluntary or not for the inducement of a supply of goods or services will constitute consideration, but it excludes any donation made to an association not for gain. Also excluded is a "deposit" which is lodged to secure a future supply of goods and held in trust until the time of the supply.

A supply for no consideration has a value of "nil", except when the supply is between connected persons.

**Domestic goods and services**

Includes -

- cleaning and maintenance;
- electricity, gas, air conditioning or heating;
- a telephone, television set, radio or other similar article;
- furniture and other fittings;
- meals;
- laundry; or
- nursing services,

when supplied together with commercial accommodation.

If a person stays for longer than **28 days** in **any** hotel, guesthouse, inn, boarding house, retirement home, or similar establishment, **only 60% of an all inclusive charge** for accommodation and domestic goods or services will be subject to VAT. Refer to section 10(10) of the VAT Act for more information.

**Donation**

A payment made voluntarily to any association not for gain for the carrying out of its objectives. The person making the payment must not receive any identifiable direct valuable benefit as a result of the gift.

**Dwelling**

Except where used in the supply of commercial accommodation, any building, premises, structure or any other place, or any part thereof, used or intended for use predominantly as a place of residence for any natural person, including all fixtures and fittings.

**Entertainment**

Means the provision of any food, beverages, accommodation, entertainment, amusement, recreation or hospitality of any kind by a vendor whether directly or indirectly to anyone in connection with an enterprise carried on by that person.

**Exempt supplies**

An exempt supply is a supply on which no VAT may be charged (even if the supplier is registered for VAT). Persons making only exempt supplies may not register for VAT and may not recover input tax on purchases to make exempt supplies.

Section 12 contains a list of exempt supplies.

Examples:

- Certain financial services.
- Supplies by any "*association not for gain*" of certain donated goods or services.
- Rental of accommodation in any "*dwelling*" including employee housing.
- Certain educational services.
- Services of employee organisations e.g. trade unions.
- Certain services to members of a sectional title, share block or retirement housing scheme funded out of levies. (Not applicable to timeshare schemes.)
- Public road and railway transport for fare-paying passengers and their luggage.
- Childcare services in a crèche or after school care centre.

**Goods**

The term “*goods*” includes –

- corporeal (tangible) movable things, goods in the ordinary sense (including any real right in those things);
- fixed property, land & buildings (including any real right in the property e.g. 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 “*goods*” excludes –

- money i.e. notes, coins, cheques, bills of exchange, etc (except when sold as a collectors item);
- value cards, revenue stamps, etc. which are used to pay taxes (except when sold as a collectors item); and
- any right under a mortgage bond.

**Grant**

An amount which a public authority (i.e. government departments and certain public entities) or a municipality has budgeted for, and pays over to other institutions or persons. The relevant department, public entity or municipality may not, however, receive any goods or services in return for these payments.

**Person**

The entity which is liable for VAT registration and includes –

- sole proprietor i.e. a natural person;
- company/close corporation;
- partnership/joint venture;
- deceased/insolvent estate;
- trusts;
- incorporated body of persons e.g. an entity established under its own enabling Act of Parliament;
- unincorporated body of persons, e.g. club, society or association with its own constitution;
- foreign donor funded project; and
- municipalities/public authorities.

**SARS**

The acronym for the South African Revenue Service

**Services**

The term “*services*” is very broad and includes –

- the granting, assignment, cession, surrender of any right;
- the making available of any facility or advantage; and
- certain acts which are deemed to be services in terms of section 8.

The term excludes –

- a supply of goods;
- money; and
- any stamp, form or card which falls into the definition of “*goods*”.

Examples:

- Commercial services - electricians, plumbers, builders.
- Professional services - doctors, accountants, lawyers.
- Advertising agencies.
- Intellectual property rights - patents, trade marks, copy rights, know-how.
- Restraint of trade.
- Cover under an insurance contract.

---

<b>Supply</b>	Includes performance in terms of a sale, rental agreement, instalment credit agreement and all other forms of supply, whether voluntary, compulsory or by operation of law, irrespective of where the supply is effected.
<b>Taxable supplies</b>	<p>Supplies (including zero-rated supplies) which are chargeable with tax under the VAT Act. There are two types of taxable supplies, namely –</p> <ul style="list-style-type: none"><li>• those which attract the zero rate (listed in section 11); and</li><li>• those on which the standard rate of 14% must be charged.</li></ul> <p>A taxable supply does not include any exempt supply listed in section 12 of the Act, even if supplied by a registered vendor.</p>
<b>VAT</b>	The acronym for value-added tax.
<b>Vendor</b>	Includes any person who is registered, or is required to be registered for VAT. Therefore any person making taxable supplies in excess of the threshold amount (presently R1 million) prescribed in section 23 is a vendor, whether they have actually registered with SARS or not.
<b>Welfare organisation</b>	Is any public benefit organisation contemplated in paragraph (a) of the definition of “ <i>public benefit organisation</i> ” in section 30(1) of the Income Tax Act, No. 58 of 1962 that has been approved by the Commissioner in terms of section 30(3) of that Act and which carries on a welfare activity. Welfare activities are listed in the schedule to Government Notice No. 112 of 11 February 2005.

## ANNEXURE A

### **Media Release No 45 of 2001: Changes to VAT on long term accommodation in hotels, boarding houses, retirement homes and similar establishments**

The special concession contained in the Value-Added Tax Act, 1991, granting relief to those individuals who are permanently in hotels, retirement homes or similar establishments has been amended effective from 01 October 2001.

Currently, the effective rate of VAT for such accommodation is reduced from 14% to 9.52% by using a rather complicated formula. This amendment to the VAT Act effectively eliminates this complicated formula and grants further relief. From 01 October 2001, the effective rate will be reduced to 8,4% on the VAT exclusive charge.

This amendment to the VAT Act is intended to compensate for the fact that individuals who live in their own or rented homes do not pay VAT on bond interest, municipal rates and rent as these charges are exempt from VAT.

As from 1 October 2001, where a person stays for longer than 28 days in any hotel, retirement home or similar establishment, only 60% of an inclusive charge for accommodation and domestic goods and services will be subject to VAT. Domestic goods and service means the supply of accommodation and, where supplied as part of the right of accommodation, meals, furniture, fittings, telephone, television, radio, cleaning, maintenance, electricity, gas, air conditioning and heating. If domestic goods and services, or any other goods and services are charged separately from the accommodation charge, they will attract VAT at 14%.

Where a resident stays for a period not exceeding 28 days, the charge is taxed in full.

The VAT rules relating to the supply of flats or cottages under rental or life-right schemes have not changed. The sale of a life-right and any monthly levy charged or, alternatively the rental of the unit is exempt from VAT. No input tax may be claimed in respect of exempt supplies.

The instructions contained in VATNEWS No 8 and 13 are withdrawn. Any portion of the monthly levy payable under a life-right, share block or sectional title scheme which relates to meals is not exempt from VAT.

## ANNEXURE B

### COMMON LAW DOMINANT IMPRESSION TEST GRID

	INDICATOR	SUGGESTS EMPLOYEE STATUS	SUGGESTS INDEPENDENT CONTRACTOR STATUS
NEAR CONCLUSIVE Control Manner/Exclusive Acquisition.	Control of manner of working.	Employer instructs (has right to) which tools/equipment, or staff, or raw materials, or routines, patents, technology.	Person chooses which tools/equipment, or staff, or raw materials, or routines, patents, technology.
	Payment regime.	Payment by a rate x time-period, but regardless of output or result.	Payment by a rate x time-period but <b>with reference to results</b> , or payment by output or "results in a time period".
	Person who must render the service.	Person obliged to render service personally, hires & fires only with approval.	Person, as employer, can delegate to, hire & fire own employees, or can subcontract.
	Nature of obligation to work.	Person obliged to be present, even if there is no work to be done.	Person only present and performing work if actually required, and chooses to.
	Employer (client) base.	Person bound to an exclusive relationship with one employer (particularly for independent business test).	Person free to build a multiple concurrent client base (esp. if tries to build client base - advertises etc).
	Risk/profit & loss.	Employer bears risk (pays despite poor performance/slow markets) (particularly for independent business test).	Person bears risk (bad workmanship, price hikes, time over-runs).
PERSUASIVE Extent of Control	Instructions/supervision.	Employer instructs on location, what work, sequence of work etc or has the right to do so.	Person determines own work, sequence of work etc. Bound by contract terms, not orders as to what work, where, etc.
	Reports.	Control through oral/written reports.	Person not obliged to make reports.
	Training.	Employer controls by training the person in the employer's methods.	Worker uses/trains in own methods.
	Productive time (work hours, work week).	Controlled or set by employer/person works full time or substantially so.	At person's discretion.
RELEVANT Labels, clauses, compliance, economic circumstances, "resonant" of	Tools, materials, stationery etc.	Provided by employer, no contractual requirement that person provides.	Contractually/necessarily provided by person.
	Office/workshop, admin/secretarial etc.	Provided by employer, no contractual requirement that person provides.	Contractually/necessarily provided by person.
	Integration/usual premises	Employer's usual business premises.	Person's own/leased premises.
	Integration/usual business operations.	Person's service critical/integral part of employer's operations.	Person's services are incidental to the employer's operations or success.
	Integration/hierarchy & organogram.	Person has a job designation, a position in the employer's hierarchy	Person designated by profession or trade, no position in the hierarchy.
	Duration of relationship.	Open ended/fixed term & renewable, ends on death of worker.	Limited with regard to result, binds business despite worker's death.
	Threat of termination/breach of contract.	Employer may dismiss on notice (LRA equity aside), worker may resign at will (BCEA aside).	Employer in breach if it terminates prematurely. Person in breach if fails to deliver product/service.
	Significant investment.	Employer finances premises, tools, raw materials, training etc.	Person finances premises, tools, raw materials, training etc.
	Employee benefits.	Especially if designed to reward loyalty.	Person not eligible for benefits.
	<i>Bona fide</i> expenses or statutory compliance.	No business expenses, travel expenses and/or reimbursed by employer. Registered with trade/professional association.	Overheads built into contract prices Registered under tax/labour statutes & with trade/professional association.
	Viability on termination.	Obliged to approach an employment agency of labour broker to obtain new work (particularly for independent business test).	Has other clients, continues trading. Was a labour broker or independent contractor before this contract.
	Industry norms, customs.	Militate against independent viability. Make it likely person is an employee.	Will promote independent viability. Make it likely person is an independent contractor or labour broker.

### CHARACTERISTICS OF AN EMPLOYMENT CONTRACT vs CONTRACT FOR WORK<sup>75</sup>

Employee (employment contract)	Independent contractor (contract for work)
The object of the contract of service is the rendering of personal services by the employee to the employer. The services are the object of the contract.	The object of the contract of work is the performance of a certain specified work or the production of a certain specified result.
According to a contract of service the employee will typically be at the beck and call of the employer to render personal services at the behest of the employer.	The independent contractor is not obliged to personally perform the work or to produce the result, unless otherwise agreed upon. The independent contractor may avail himself of the labour of others as assistants or employees to perform the work or to assist in the performance of the work.
Services to be rendered in terms of a contract of service are at the disposal of the employer who may in the employer's own discretion (subject, of course, to questions of repudiation) decide whether or not the services are required.	The independent contractor is bound to perform a certain specified work or produce a certain specified result within a time fixed by the contract of work or within a reasonable time where no time has been specified.
The employee is subordinate to the will of the employer. The employee is obliged to obey the lawful commands, orders or instructions of the employer who has the right of supervising and controlling the employee by prescribing what work has to be done as well as the manner in which it has to be done.	The independent contractor is notionally on a footing of equality with the employer. The independent contractor is bound to produce in terms of the contract of work, not by the orders of the employer. The independent contractor is not under the supervision or control of the employer, and is not under any obligation to obey any orders of the employer in regard to the manner in which the work is to be performed. The independent contractor is its own master.
A contract of service is terminated by the death of the employee.	The death of the parties to a contract of work does not necessarily terminate it.
A contract of service terminates on expiration of the period of service entered into.	A contract of work terminates on completion of the specified work or on production of the specified result.

<sup>75</sup> *SABC v McKenzie [1999] 1 BLLR 1 (LAC).*

## 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 SARS’ website the go to “SARS Large Business Centre”.

### SARS Service Monitoring Office

**Telephone**

0860 12 12 16

**Fax**

(012) 431 9695

(012) 431 9124

**Postal Address**

PO Box 11616  
Hatfield  
0028  
South Africa

**Website**

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

**email**

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

### 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
<b>Income Tax</b>	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>
<b>Value-Added Tax (VAT)</b>	0800 00 7277	021 413 8902	<a href="mailto:vat.wc@sars.gov.za">vat.wc@sars.gov.za</a>
<b>Pay As You Earn (PAYE)</b>	0800 00 7277	031 328 6013	<a href="mailto:paye.cc@sars.gov.za">paye.cc@sars.gov.za</a>
<b>Tax Clearance Certificates</b>	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>
<b>Customs: General</b>	0800 00 7277	031 328 6017	<a href="mailto:customs.qry@sars.gov.za">customs.qry@sars.gov.za</a>
		021 413 8909	<a href="mailto:cqry.wc@sars.gov.za">cqry.wc@sars.gov.za</a>
<b>Tax Practitioners</b>	0860 12 12 19	011 602 5049	<a href="mailto:pcc@sars.gov.za">pcc@sars.gov.za</a>
<b>Tax Practitioners: eFiling</b>	0860 12 12 19	011 602 5312	<a href="mailto:pccefiling@sars.gov.za">pccefiling@sars.gov.za</a>