

**AN EXAMINATION OF THE RELATIONSHIP BETWEEN INPUT TAX AND
TAXABLE SUPPLIES ACCORDING TO THE VALUE ADDED TAX ACT 89 of 1991**

by

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DECLARATION

I, **DELIAH TAVAGWISA CHINYATI** hereby declare that the dissertation is my own, unaided work. It is being submitted in partial fulfilment of the prerequisites for the degree of Masters in Mercantile Law at the University of Pretoria. It has not been submitted before for any degree or examination in any other university.

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ABSTRACT

This dissertation paper discusses the relationship between input tax and taxable supplies according to the VAT Act. Value added tax (VAT) is the tax that is charged on each transaction in the production and distribution chain of a manufactured product. VAT was introduced for the first time in South Africa in September 1991 at 10 per cent and is regulated by the Value Added Tax Act 89 of 1991. South Africa is among the many countries in the world that charge VAT.

It is the final consumer who carries the tax burden. Output tax is defined as the tax charged by any vendor on the goods or services supplied by that vendor in respect of the supply of goods or services by that vendor in the furtherance of any enterprise carried on by him¹. Input tax is defined as the tax payable by a vendor when goods or services are acquired by him wholly for the purposes of consumption, use or supply in the course of making taxable supplies.² Tax has been defined as a fee charged by a government on a product, income or activity.³ VAT vendors need to account for the difference between input tax and output tax to the Receiver of Revenue at the end of each tax period. In circumstances where input tax exceeds output tax, the Receiver of Revenue pays the difference to the vendor. If output tax exceeds input tax, then the vendor is liable to the Receiver of Revenue.

There are generally two types of taxes, namely direct and indirect taxes. Direct taxes are those for which the tax burden cannot be shifted to another, while indirect taxes can be shifted to the next person who is the final consumer in the distribution chain. This dissertation focuses on indirect taxes, and in particular on VAT.

There are various cases that were adjudicated by both the courts in South Africa and internationally, where the parties could not reach an understanding on the input tax deductions. An example would be in *ITC 1744 (65 SATC 154)*, a South African case where it was held that an input tax deduction could only be allowed if the expenditure was incurred in the actual making of taxable supplies by the vendor, not in the preparation stages of the business. Internationally, the case of *BLP Group PLC v Customs and Excise Commissioners*

¹M Silver and C Beneke *Deloitte VAT Handbook*. 10 ed. (2015) 114

²M Silver and C Beneke *Deloitte VAT Handbook*. 10 ed. (2015) 115

³<http://www.investorwords.com/4879/tax.html>

worth noting. The issue was whether the VAT charged by a financial advisor who gave advice on the sale of shares was claimable as input tax. The court ruled that the vendor in these circumstances could not claim an input tax deduction as the service was used for an exempt transaction.

From the research that was conducted, it was noted that there is no consistency in the deduction of input tax incurred in the making of taxable supplies. It is recommended that the legislature consider drafting an interpretation note on this subject for the purpose of collecting input tax.

10 KEY TERMS USED IN THIS PAPER

1. Input tax means the VAT paid by the vendor when acquiring goods or services in the process or for the purposes of making taxable supplies.
2. Output tax is defined as the tax which is charged when a vendor supplies goods or services in the course of conducting any enterprise.
3. Exempt supply is a supply on which no VAT is leviable.
4. Zero-rated supply is a supply made by a vendor which is taxed at zero rate.
5. VAT vendor is a person who is registered or is required by law to be registered for VAT purposes.
6. Receiver of Revenue is a finance department of the government which collects income on its behalf.
7. Supply is defined as all forms of supply, irrespective of where the supply is effected. For an act to qualify as a supply, some form of act is required from the vendor. It includes performances in sale agreements, rental agreements and instalment agreements, whether voluntarily or by compulsion.
8. Enterprise means any activity carried on continuously or regularly, by any person in the Republic or partly in the country, in the course or furtherance of which goods or services are supplied to any other person for consideration whether or not for profit.
9. Goods are defined in Section 1 of the Act as the corporal movable things, fixed property and any real right in any such thing or fixed property and electricity.
10. Services are described as anything done or to be done, including granting, assignment, cession or surrender of any right or the making available of any facility or advantage.

TABLE OF ABBREVIATIONS

1. VAT- Value Added Tax
2. GST – General Sales Tax
3. SARS – South African Revenue Services
4. IT – Income Tax
5. DBCM – De Beers Consolidated Mines Ltd
6. RG – Redrow Group
7. CSAR – Commissioner for South African Revenue Service
8. VAT Act – Value Added Tax Act 89 of 1991

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CHAPTER 1 – INTRODUCTION

1.1 BACKGROUND

In South Africa, value added tax (VAT) was initially introduced in September 1991 at 10 per cent. Value added tax is the tax that is charged on each transaction in the production and distribution chain of a manufactured product. According to Section 7 (1) (a) of the Act,⁴ ‘Subject to the exemptions, exceptions, deductions and adjustments provided for in this Act, there shall be levied and paid for the benefit of the National Revenue Fund a tax, to be known as the value added tax on the supply by any vendor of goods or services supplied by him on or after the commencement date in the course or furtherance of any enterprise carried on by him’.

Under the current VAT system, it is the final consumer who gets the tax burden as the businessman who buys the goods for resale will eventually deduct the VAT they would have paid on acquiring the goods as input tax. Businesses need to account to the Receiver of Revenue at the end of each tax period for the difference between their input tax and their output tax. In circumstances where a VAT vendor’s output tax exceeds their input tax, the vendor has to pay the difference to the South African Revenue Services (SARS). If, however, the input tax exceeds the vendor’s output tax, the Receiver of Revenue has to refund the difference to the vendor.

There are certain terms that are used in the VAT process that will be discussed briefly here. First, the term output tax according to Section 1 means ‘the tax charged on the supply by any vendor of goods or services supplied by that vendor on or after the commencement of the VAT Act in the course or furtherance of any enterprise carried on by him in respect of the supply of goods and services by that vendor’.⁵

Input tax is the tax payable by a vendor when goods or services are acquired by him wholly for the purposes of consumption, use or supply in the course of making taxable supplies.⁶ Taxable supplies are defined by scholars⁷ as any supply in terms of sales of delivery of goods or services chargeable with tax; included are those services in which the tax is chargeable at zero percent. In order for the VAT to be claimable as input tax, the goods or services must be acquired by a vendor to be used for the sole

⁴ Value Added Tax Act Number 89 of 1991 as amended

⁵ s 1 of the Value Added Tax Act Number 89 of 1991 as amended

⁶ M Silver and C Beneke op cit at 115

⁷ Louis Botha ‘Cars, taxable supplies and input VAT’: tax source without prejudice 16, 32-3

purpose of making taxable supplies. Before input tax can be claimed from SARS, there are two requirements that have to be fulfilled. The first one is that the goods must be acquired for the purposes of consumption, use or supply in the course of making taxable supplies by a person who is registered with the Receiver of Revenue as a VAT vendor. If the person is not a vendor, then the VAT incurred in acquiring those goods will not be classified as claimable input tax. The second requirement is that input tax is the tax payable in respect of goods or services which have been acquired by the vendor solely for the purposes of making taxable supplies. The elements in the definition of input tax will be discussed in this research.

The supply of goods or services by a vendor in these circumstances refers to any supply made by a vendor of goods or services in the course or the furtherance of the enterprise carried on by him. According to Kathy,⁸ the taxpayer is effectively required, for the purposes of input tax, to group all his expenses into three main categories, namely expenses incurred wholly for the purposes of use, supply or consumption in the course of making taxable supplies, expenses incurred wholly for non-taxable purposes and those incurred partially for taxable and partially for non-taxable or dual supplies.

The fact that a VAT vendor has their valid tax invoice does not mean that they will be able to claim all their input tax. Section 17 (1) of the Value Added Tax Act explains that vendors cannot claim all their input tax if their expense relates to both taxable and non-taxable supplies. In these circumstances, apportionment of the input tax must be done.⁹ Further, the absence of a tax invoice should not bar the vendor from submitting a claim from the Receiver of Revenue if they have the proper supporting documents to prove their case and if the documents can be acceptable to SARS.¹⁰ According to Lockem,¹¹ the recipient vendor may use any other document that has sufficient information to determine the particulars of the supply, to substantiate

⁸ Kathy Thersby 'Input Tax claims taken for granted now under scrutiny' Tax Breaks Newsletter, Volume 2006, issue 240, Jan 2006, p6.

⁹HJA Smit 'An in-depth study of input tax apportionment methods for value added tax in South Africa' (2009) iii. The article states that the institutions that are affected the most by Sec 17(1) if the Act are banks, municipalities and universities as they have large amounts of exempt supplies with expenses incurred that cannot be allocated specifically to a certain income. Smit suggests that apportionment of the input tax must be applied to determine the input tax deductions on the income.

¹⁰Pricewaterhousecoopers. '9/8No proper tax invoice? Input VAT may still be claimed.' Source : TaxBreaks Newsletter, Volume 2017 Number 375, Apr 2017, p. 7 - 8

their entitlement to the deduction of input tax. The document must however, be a document that is acceptable to the Commissioner.

The word supply in this context used to be defined as including all forms of supply, irrespective of where the supply is effected. This definition was changed as a result of the outcome of the *Shell's Annandale Farm (Pty) Ltd v Commissioner for the South African Revenue Service* (62 SATC 97) case.¹² The details of this case will not be discussed at this point but after this case, the definition of supply was widened and now includes all forms of performance. It now can include any provision of goods or services by a vendor in the course of his enterprise. A VAT vendor is a person who is required to register for VAT purposes. Goods are defined in Section 1 of the Act as the corporeal movable things, fixed property and any real right in any such thing or fixed property and electricity.¹³ Services are described as anything done or to be done, including granting, assignment, cession or surrender of any right or the making available of any facility or advantage.¹⁴

Input tax can, however, be denied even though the goods were purchased for the purposes of making taxable supplies. These are circumstances where the goods are for the purposes of entertainment or the input tax on motor vehicles as defined by the Act. This research will analyse case law on the relationship between input tax and taxable supplies. Among the cases that will be discussed is *Commissioner, South African Revenue Services v Pretoria East Motors (Pty) Ltd*¹⁵ where the SARS officials were arguing that there was an unjustifiable deduction of input tax by the respondent and there was an under declaration of supplies as well as of output tax. The case of *South Atlantic Jazz Festival (Pty) Ltd v Commissioner, South African Revenue Services*¹⁶ will also be discussed in this research.

¹¹ Anton Lockem 'How to substantiate an input tax deduction without a tax invoice: features indirect tax' source TAXtalk 2015 pp68 (2015).

¹² *Shell's Annandale Farm (Pty) Ltd v Commissioner for the South African Revenue Service* (62 SATC 97)

¹³ Section 1 of the Value Added Tax Act No 89 of 1991 under the definition clause. The definition excludes among other things money, rights under mortgage bond or fixed property and any stamp, form or card which has a money value and has been sold.

¹⁴ Section 1 of the Value Added Tax Act No 89 of 1991. Excluded from the definition is a supply of goods, money or any stamp, form or card mentioned under the definition of goods.

¹⁵ *Commissioner, South African Revenue Services v Pretoria East Motors (Pty) Ltd* 2014 (5) SA 231 (SCA).

¹⁶ *South Atlantic Jazz Festival (Pty) Ltd v Commissioner, South African Revenue Services* 2015 (6) SA 78 (WCC).

1.2 RATIONALE OF STUDY

The topic of the relationship between input tax and taxable supplies appears extensively in South Africa and internationally. It is important to define the link between input tax and taxable supplies in order to assist vendors to make informed decisions on how to use their raw materials. It is essential that they know that they do not claim all their input tax if they use part of their purchases for personal use and some for taxable supplies. There is also limited literature that compares the South African input tax relationship with the input tax of jurisdictions of the European Union. This research will improve the South African position by comparing it with other jurisdictions and examining whether there are any lessons that can be learnt from other jurisdictions.

1.3 RESEARCH METHODOLOGY

The methodology adopted for this research consists of a critical and comparative legal analytic review of the relevant legislation, case law and literature of other jurisdictions compared to the South African position. The positions of the European Union and Canada will be analysed in comparison to the South African position. These jurisdictions have been chosen for analysis as they are among the jurisdictions with developed tax implementation.

1.4 PROBLEM STATEMENTS

The research will respond to the following questions:

1. What is the acceptable relationship between the taxable supply and the input tax to be claimed?
2. What are the principles underlying this relationship?
3. What are the background, scope, strengths and weaknesses of the current situation in South Africa?
4. Is the current situation in South Africa effective in managing the input tax deductions on the taxable supplies made for the purposes of making taxable supplies?

5. What measures are in place in South Africa to combat claiming more than what is actually allowed with regards to input tax?
6. What lessons can we learn from other jurisdictions regarding the nexus between input tax and input tax deductions?

1.5 CHAPTER OUTLINE

This research is structured as follows:

Chapter 1 will deal with the background and introduction to the topic.

In Chapter 2, I will discuss the South African VAT law and systems. The South African legislation relating to input tax will be explored. More background definitions of input tax in South Africa will be explained in this chapter.

Chapter 3 will discuss the position in the European Union. The legislation in these countries will be discussed, as well as the available literature.

Chapter 4 concludes this research by providing final conclusions regarding the efficacy of the South African position at this moment. These conclusions are motivated by the detailed review of the South African position of the relationship between input tax and the taxable supplies. Chapter 4 also contains recommendations for legislative changes that should be made to the South African legislature.

CHAPTER 2 – SOUTH AFRICAN VAT LAW AND SYSTEM

2.1 INTRODUCTION

In order to properly understand input tax, it is important to have a general understanding of tax and the concepts used in the subject of tax. This chapter will be an in-depth definition of tax. In the process, key concepts such as input tax and output tax will be discussed, and other taxes like direct and indirect taxes will be defined.

In order to explore input tax with proper understanding, the history of the VAT system in South Africa will be discussed, beginning with the general sales tax, how it was applied in South Africa and how it was changed by introducing the VAT system. The introduction of VAT was a highly politicised affair which was met with a high level of criticism. The arguments against the introduction of the VAT system will be explored. However, those controversies were unsuccessful in stopping the introduction of VAT.

South Africa is not the only country in Africa or in the world that charges VAT. The introduction of VAT in the world will be discussed and other countries in Africa that charge VAT will be identified, as well as the VAT rate they charge on goods and services. VAT legislation in South Africa will be discussed later in this chapter, followed by the process of becoming a registered VAT vendor and the consequences of registration. The overarching aim of this chapter is to start an investigation into the relationship between input tax and taxable supplies by defining the concepts they are used in.

2.2 DEFINITION OF TAX

To understand the concept of input tax, one has to understand the definition of tax as defined by various dictionaries and scholars. Tax can be defined as compulsory contributions towards state revenue, levied by the government on workers' incomes and business profits or added to the cost of some goods, services and transactions. It has also been defined as a fee charged by a government on a product, income or

activity.¹ Tax has also been defined by Waite and Hawker in the Oxford Dictionary as ‘money that must be paid to the state, charged as a proportion of income and profits or added to the cost of some goods and services’.² Law and Owen define tax as a ‘levy on individual or corporate bodies by central or local government in order to finance the expenditure of that government and also as a means of implementing its fiscal policy’.³

Legal scholars have defined tax as a compulsory levy imposed by government for public purposes.⁴ According to Thuronyi, any imposition of costs on individuals or firms by the government can be considered a tax. Thuronyi also states that ‘[t]ax might be defined as a required payment to government’.⁵ Lymer and Oats⁶ define tax as ‘a compulsory levy, imposed by government or other tax raising body on income, expenditure or capital assets, for which the taxpayer receives nothing specific in return.’

2.3 TYPES OF TAXES

There are generally two types of taxes that are payable to the Receiver of Revenue, namely direct and indirect taxes. Direct taxes are taxes to which the tax burden cannot be shifted like income tax, which is the tax paid by the person on whom the obligation lies. Indirect taxes are taxes whose tax burden can be shifted to another, for example, VAT and customs duty. These taxes are shifted onto another person in the sense that, when businesses buy their stock, they pay input tax on those goods. They later claim the input tax they would have paid back from the Receiver of Revenue. The final consumer will bear the tax burden in that they will not be able to claim their money back from the Receiver of Revenue as input tax, as they would have acquired the goods for their own personal use. This dissertation focuses on these indirect taxes and, in particular on VAT.

¹<http://www.investorwords.com/4879/tax.html>

²Waite and Hawker (eds) *Oxford Dictionary & Thesaurus* (2009) 952. According to Oxforddictionaries.com at <http://oxforddictionaries.com/definition/english/tax?q=tax> (accessed on 22/12/2016) a tax is ‘a compulsory contribution to state revenue, levied by government on worker’s income and business profits, or added the cost of some goods, services, and transactions’

³*Oxford Dictionary of Accounting* 9 (2010) 409. G Wanjialin *An International Dictionary of Accounting and Taxation* (2004) 385 defines tax as a ‘charge imposed by a government body on personal and corporate income, estates, gifts or other sources to obtain revenue for the public good’.

⁴Morse and Williams *Principles of Tax Law* (2000) 3

⁵*Comparative Tax Law* (2003) 45

⁶*Taxation Policy and Practice* (2009/2010) 3.

2.4 HISTORICAL BACKGROUND OF THE VAT SYSTEM IN SOUTH AFRICA

2.4.1 *General Sales Tax*

In South Africa, the initial tax to be introduced on the consumption of goods and services was the general sales tax (GST), which was introduced for the first time in 1978. The GST was generally a sales tax and did not cover goods and services as much as those covered by its successor, the VAT. The GST was initially introduced at a much lower rate of 4 percent and VAT was introduced initially at 10 percent.⁷

GST was replaced by VAT because of a number of perceived deficiencies. First, it was presumed that since the GST was a single stage collection system, the government was losing a lot of revenue through tax evasion than it is with the VAT.⁸ GST is collected on value-added goods and services at each stage of sale or purchase in the supply chain. GST paid on the procurement of goods and services can be set off against that payable on the supply of goods or services. The manufacturer, wholesaler or retailer will pay the GST but will claim it back through the tax credit mechanism.⁹ The GST is passed on to the next person until the consumer, which is how indirect taxation operates. The difference is that with the streamlining of the multiple taxes, the final cost to the consumer will end up lower on the elimination of double taxation.

Further, it was noted that under the GST system the tax was generally only charged on the sale to the final consumer, not at all stages of production; so if the retailer failed to hand over the tax he would have collected from the consumer to the government, the government got no tax at all. With the VAT system on the other hand, the government has a lot of people collecting tax on its behalf and it gets collected at every stage of production and distribution.

Under the VAT system, the tax is charged on each transaction in the production and distribution chain. As an example, the manufacturer pays R100 to purchase taxable supplies. In that R100 the manufacturer paid R14 in input tax when he acquired the taxable supplies from the producer and later makes R200 in sales. In the end, he has

⁷ See generally M Silver and C Beneke op cit at 3

⁸ The GST is a tax system where the tax is charged at the final destination or to the final consumer of the goods or services rather than at every stage of production of the goods as is the case with the VAT.

⁹<http://www.relakhs.com/gst-goods-services-tax-in-india/>

received R28 in output tax. The difference between the input tax he would have paid and the output tax he would have received is R14 which the manufacturer is obliged to pay to the Receiver of Revenue as VAT. This process goes on to the wholesaler who purchases the goods from the manufacturer, as well as the retailer who sells the goods to the final consumer. The retailer can claim his input tax from the Receiver of Revenue, but the final consumer who purchases the goods for his personal use cannot claim anything from the Receiver of Revenue, thus the consumer bears the burden of VAT. In addition, the system of input and output tax means that there can be a reasonably traceable audit trail for revenue officials to be able to check if the retailers have paid their taxes or not.

Another important aspect of the GST is that it is essentially a tax-on-tax in the sense that the business does not pay tax on the raw materials it uses to produce the goods it sells or its trading stock. It only pays tax on its capital and intermediate items and that tax is finally costed to the consumer who buys the final product. The tax is therefore a tax-on-tax, as the sale to the final consumer attracts GST. Under the VAT system, the business is allowed to deduct its input tax and that eliminates the tax-on-tax system. The tax-on-tax system increases the costs to the business, which puts them at a disadvantage in their international competitiveness.¹⁰

2.4.2 *Value Added Tax*

Although VAT was first introduced in France in 1948, it has become a system that exists in almost all the economies of the world except the United States of America. It was next implemented by Cote d'voire and Senegal in the 1960s until it spread to all the continents in the world.

In September 1991, South Africa replaced the GST with the VAT, which is a consumption type of tax. It was regarded as a superior tax which would replace the shortfalls of the GST system. The VAT was introduced at a rate of 10 percent, which was a lot more than its predecessor, which was at 4 percent. Initially, there were questions about whether the VAT would be able to replace the GST as a government

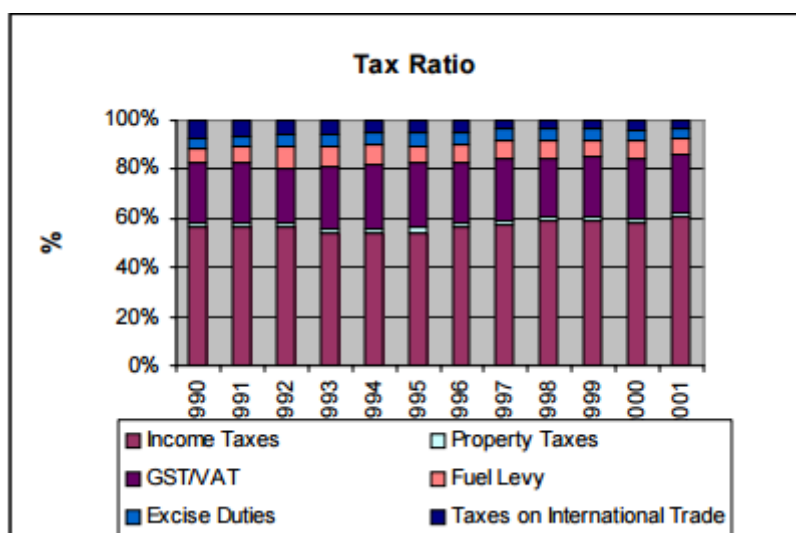
¹⁰ See generally M Silver and C Beneke op cit at 4

source of revenue.¹¹ The VAT was raised to where it is currently, at 14 percent, in 1993 and has remained unchanged for more than two decades.¹² Generally, the VAT is performing well as a revenue source for the government, which resulted in the government announcing that VAT is a dependable and broad-based revenue source for the country.

2.4.3 Controversies surrounding the introduction of the VAT system

When the VAT was introduced in 1991, there were controversies, with some people arguing that it could not replace the GST as a satisfactory and stable source of government revenue. In the first ten years after its introduction, it can be noted that VAT was the second largest revenue generator for the government after income taxes, and the importance of VAT has been constant over the years. The diagram below illustrates the importance of VAT and compares it to other South African taxes from the year 1990 until 2001 when the graph was compiled. VAT was immediately a huge contributor to tax collection.

Figure 1: VAT compared to other South African Taxes 1990-2001



An Analysis of South Africa's Value Added Tax

¹¹Delfin S. Go, Marna Kearney, Sherman Robinson, Karen Thierfelder, 'An analysis of South Africa's Value Added Tax' April 2004 <https://www.gtap.agecon.purdue.edu/resources/download/1816.pdf>

¹²<http://www.pwc.co.za/en/assets/pdf/vat21-september-2012.pdf>8 (accessed 11/11/2016)

Figure 2: A recent graph on the contribution of VAT as a source of tax in South Africa as at 2015¹³

Table 1.1: Tax register, 31 March 2011 - 31 March 2015

Number as at	Individuals ^{1,2}	Companies (CIT) ^{1,3}	Trusts ¹	Employers ¹ (PAYE)	VAT Vendors ¹	Importers	Exporters
31 Mar 2011	10 346 175	2 078 182	326 649	386 428	664 267	238 779	217 359
31 Mar 2012	13 703 717	2 034 719	301 365	384 883	652 349	247 595	224 216
31 Mar 2013	15 418 920	2 195 883	312 066	391 254	650 540	265 497	240 709
31 Mar 2014	16 779 711	2 685 405	322 188	407 066	662 194	272 544	246 500
31 Mar 2015	18 185 538	2 935 385	331 584	429 691	679 274	280 953	254 108
Percentage year-on-year growth							
31 Mar 2012	32.5%	-2.1%	-7.7%	-0.4%	-1.8%	3.7%	3.2%
31 Mar 2013	12.5%	7.9%	3.6%	1.7%	-0.3%	7.2%	7.4%
31 Mar 2014	8.8%	22.3%	3.2%	4.0%	1.8%	2.7%	2.4%
31 Mar 2015	8.4%	9.3%	2.9%	5.6%	2.6%	3.1%	3.1%

1. Excludes cases where status is in suspense, estate and address unknown.

2. The tax year for individuals starts on 1 March and ends at the end of February the following year. The number of individuals registered for income tax has increased since March 2011 due to the revised employer filing requirements.

3. The tax year for companies is normally the financial year of the company for financial reporting purposes.

2.4.4 Types of tax systems

A tax system falls within one of the following three main categories: regressive, proportional or progressive. These tax systems will be discussed briefly below.

Regressive taxes are those taxes that have a greater impact on low income individuals or entities than high income earners. There are also proportional taxes which are also known as flat taxes. These flat taxes impacts low, middle and high income earners relatively equally. Lastly is the progressive taxes category. These taxes have more of an impact on higher income individuals and businesses and less of a financial impact on low income earners.¹⁴The South African VAT system falls under the regressive category.¹⁵

¹⁴<http://www.investopedia.com/ask/answers/042415/what-are-differences-between-regressive-proportional-and-progressive-taxes.asp>

¹⁵Under a regressive tax system, individuals and entities with low incomes pay a higher amount of that income in taxes compared to high-income earners. The system does not implement a tax liability that is based on the individual or entity's ability to pay, the government assesses tax as a percentage of the asset that the taxpayer purchases or owns. An example would be a sales tax on the purchase of everyday products or services which is assessed as a percentage of the item bought and is the same for every individual or entity. However, a sales tax of 7 percent has a greater burden on lower-income earners than it does on the wealthy because the ability to pay is not taken into consideration.

The greatest controversy that arose when the VAT system was introduced was the inflation effect of VAT. It was argued that if the VAT is introduced or increases, then the value of the goods in the retail shops increases, thereby raising inflation. Studies have however shown that an increase in VAT will not necessarily mean an increase in the value of goods. The extent to which prices increase depends on how the producers are able to shift the tax burden to the consumers, which will also depend on the supply and demand elasticities, therefore VAT itself cannot cause inflation. All the criticisms did not hold as VAT was introduced anyway.

2.5 COUNTRIES THAT CHARGE VAT IN AFRICA AND THE WORLD

South Africa is not the only country that has introduced the VAT system as a revenue source for the government. Almost all countries charge general consumption tax. VAT is charged by 164 countries in the world¹⁶ as tax on the sale of most goods and services to consumers. In North America, only 1 country charges VAT. 18 Countries in Central America and the Caribbean, 12 Countries in South America, 28 countries in Asia, 51 countries in Europe as well as 8 countries in Oceania also charge VAT. 46 of these countries that charge VAT are in Africa. The table below show the countries that

Under the progressive tax category, the proportion of tax liability rises as an individual or entity's income increases. Tax burdens are meant to be more of an imposition to wealthy, high-income earners than they are to low or middle class individuals. Taxes are assessed on income and business profits are based on a progressive or increasing tax rate schedule. Marginal tax rates under a progressive tax system are often higher than the average tax rates that are paid. Estate taxes are an example of progressive taxes, as a greater burden is placed on wealthy individuals.

A proportional tax system, or a flat tax system, assesses the same tax rate to taxpayers regardless of income or wealth. It is meant to create equality between the taxpayers. Under a proportional tax system, individual taxpayers pay a set percentage of their income regardless of total income earned. An example would be that of income tax of 10 percent that does not increase or decrease as income rises or falls results in a proportional tax. In this example, an individual who earns R30 000 monthly pays R3 000 under a proportional tax system, while someone who earns R200 000 per month pays R20 000 in taxes.

¹⁶ As of 1 January 2014... *Consumption Tax Trends 2014 VAT/GST and excise rates, trends and policy issues. Annex B countries with VAT:*http://www.oecd-ilibrary.org/uplib/idm.oclc.org/taxation/consumption-tax-trends_19990979;jsessionid=73s9qfxb4mh9m.x-oecd-live-03

charge VAT in Africa, the year of its implementation, as well as the standard rate applicable in each country.¹⁷

Figure 3: Countries that charge VAT in Africa

No.		Year of implementation	Standard rate 2014 (%)
Africa			
1	Algeria	1992	17.0
2	Benin	1991	18.0
3	Botswana	2002	12.0
4	Burkina Faso	1993	18.0
5	Burundi	2009	18.0
6	Cameroon	1999	19.25
7	Cape Verde	2004	15.0
8	Central African Republic	2001	19.0
9	Chad	2000	18.0
10	Congo (Democratic Republic)	2012	16.0
11	Congo (Republic)	1997	18.0
12	Djibouti	2009	7.0
13	Ethiopia	2003	15.0
14	Egypt	1991	10.0
15	Equatorial Guinea	2005	15.0
16	Gabon	1995	18.0
17	Gambia	2013	15.0
18	Ghana	1998	12.5
19	Guinea	1996	18.0
20	Guinea-Bissau	2001	15.0
21	Ivory Coast	1960	18.0
22	Kenya	1990	16.0
23	Lesotho	2003	14.0
24	Madagascar	1994	20.0
25	Malawi	2002	16.5
26	Mali	1991	18.0
27	Mauritania	1995	14.0
28	Mauritius	1998	15.0
29	Morocco	1986	20.0
30	Mozambique	1999	17.0
31	Namibia	2000	15.0
32	Niger	1986	19.0
33	Nigeria	1994	5.0
34	Republic of Congo	2012	16.0
35	Rwanda	2001	18.0
36	Senegal	1980	18.0
37	Seychelles	2012	15.0
38	Sierra Leone	2009	15.0
39	South Africa	1991	14.0
40	Sudan	2000	10.0
41	Tanzania	1998	18.0
42	Togo	1995	18.0
43	Tunisia	1988	18.0
44	Uganda	1996	18.0
45	Zambia	1995	16.0
46	Zimbabwe	2004	15.0

¹⁷ OECD (2014), 'Countries with VAT', in *Consumption Tax Trends 2014: VAT/GST and excise rates, trends and policy issues*, OECD Publishing, Paris. DOI: <http://dx.doi.org/10.1787/ctt-2014-9-en>

2.6 LEGISLATION

In South Africa, the backbone of the VAT legislation is the Value Added Tax Act Number 89 of 1991 as amended. The Act came into force in September 1991. Before then, there was a GST which had been implemented in 1978. As mentioned above, the GST had a much lower rate than the VAT and it covered fewer items than the ones which the VAT covers. The purpose of both the GST and the VAT was to collect revenue for the state.¹⁸

Under the current VAT system, it is the person who acquires the goods or services for private use who carries the burden of the tax, as most businesses in the chain deduct the VAT they pay as input tax.

2.7 REGISTRATION AS A VAT VENDOR

There are various ways in which to register to become a VAT vendor. There is compulsory and voluntary registration as a VAT vendor.

First, any business conducting a large business and has a turnover of more than 1 million rand per annum is required to register as a VAT vendor and account for VAT to the Receiver of Revenue. According to section 23(1), where a person has written a contractual obligation to make taxable supplies exceeding 1 million rand, that person is required to register as a VAT vendor at the beginning of that month. In addition, if a person is a foreign supplier of electronic goods to the South African customers, and the taxable supply is more than R50 000.00, that person is, according to Section 23 (1A), required to register as a VAT vendor. The criteria for compulsory registration is considered to be objective rather than subjective, as it is based on the supplies previously made, or a written contractual obligation for making taxable supplies in the future.¹⁹

For a person to be required to register as a VAT vendor, he must be conducting an enterprise. The word enterprise in this case means a person who is carrying on an activity, whether or not for the purposes of making profits. However, a person who is

¹⁸ M Silver and C Benekeop cit at 3

¹⁹Ibid at 149

conducting an enterprise of rendering exempt supplies may not in fact register as a VAT vendor. According to section 1 of the Act, an enterprise means any activity which is carried on continuously or regularly by any person in the Republic, or partly in the Republic, and in the course or furtherance of which goods or services are supplied to any other person for consideration, whether or not for profit.²⁰

There is also voluntary registration which is provided by the VAT Act under Section 23(3). This is for smaller businesses which have an annual turnover of less than one million rand but more than R50 000, which may voluntarily apply and register to become VAT vendors. There are certain criteria that an organisation is supposed to meet in order to be allowed to register as a VAT vendor.

First, share block companies, municipalities' welfare organisations and foreign donor projects are allowed to register as VAT vendors. This is not applicable to any association not for gain. To add, any person who has a total amount of taxable supplies of R50 000.00 in the preceding year of the proceeding period or the person whose turnover is less than R50 000.00 for the preceding year but is likely or reasonably expected to exceed that amount within 12 months of that registration may apply and register as a VAT vendor.

In addition, any person who intends to carry on business at a future specified date, who is purchasing the business as a going concern, and the business has made more than R50 000.00 in the hands of the seller during the previous 12 months may apply to be registered as a VAT vendor. Lastly, a person who continuously and regularly carries on an enterprise which is of a nature set out in the regulation and by virtue of its nature, is reasonably expected to result in taxable supplies being made for consideration only after a long period of time. A person who is in the business of supplying commercial accommodation may be allowed to voluntarily register as a VAT vendor if he has a minimum turnover from the said commercial accommodation of not less than R60 000.00 per annum.

SARS may refuse the application for the registration of a person if the person has no fixed place of abode or business or does not keep proper accounting records related to that enterprise, has not opened a bank account and has previously been

²⁰ Section 1 of the Value Added Tax No. 89 of 1991.

registered as a vendor in respect of any enterprise, but failed to perform their duties under the Act.²¹

2.8 CONSEQUENCES OF REGISTERING FOR VAT

The effect of registration as a VAT vendor is that after registration, whether voluntarily or by compulsion, the vendor is now required by the law to account for output tax to the Receiver of Revenue in respect of all the taxable supplies made by them. They are also allowed to claim an input tax deduction on all the goods that they acquire for the purposes of making taxable supplies. A vendor is required to submit a return in respect of each and every tax period.

A non-vendor is not entitled to claim any input tax and is also not accountable to the Receiver of Revenue for the output tax that they would have collected. This means that the input tax borne by the non-vendor for the goods or services acquired by him is part of the cost to them.

2.9.1 COMPONENTS OF VAT IN SOUTH AFRICA

2.9.2 *Standard Rated Tax*

There are different types of taxes in South Africa. The first one is the standard rated tax. Under this category falls the VAT paid on the supplies made on everyday transactions. These supplies are calculated by adding 14 percent to the value of the supply. An example would be a book that costs R5, then we multiply by 14 percent to get R0.70. It means the VAT, R0.70, is added to the value of the book. The VAT is then added to the price of the book and the total price of the book will now become R5.70. The above is an example of standard rated supplies.

2.9.3 *Zero-rated Supplies*

²¹ See generally M Silver and C Benekeop cit at 151

Goods or services supplied by vendors may also be treated as zero-rated supplies. Zero-rated supplies are taxable supplies made by a vendor which are taxed at zero. Under this section, no output tax is actually charged. The zero rated supply is a taxable supply so the vendor obtains a full deduction for the tax payable by him on all goods and services acquired and utilised by him in making the supply, his input tax. There is, therefore, no VAT earned by the Receiver of Revenue on zero rated supplies.

Zero-rated supplies are regulated in terms of Section 11 of the Value Added Tax Act. Section 11(2) of the Act contains those services which may be zero-rated. In short, these services are either international transport and related services or those services that have to do with the supply of services to non-residents of South Africa.²² A resident of the Republic is someone who is a resident in the Republic in the general meaning of the word. Further, the exports of goods, the sale of business as a going concern, the sale of gold coins, petroleum products, certain basic food stuffs as well as certain inputs used by farmers and certain payments received by welfare organisations are all zero rated.

Recently, the Supreme Court had to decide on whether the services supplied by a welfare organisation are zero rated for the purposes of the VAT in the case of *Marshall NO and Others*²³ Section 8(5)²⁴ of the VAT Act provides that a designated entity shall be deemed to supply services to any public authority to the extent of any payment made by the public authority in the course or furtherance of an enterprise carried on by that designated entity. The court reversed the High Court judgment and held that payments received for aero-medical services provided by a VAT vendor, welfare organisation and designated entity as defined to the provincial government nationally were not zero rated for VAT in terms of section 11 (2)(n) read with section 8(5) but were actually taxable at the standard rate.²⁵

²² M Silver and C Beneke op cit at 93

²³ *Commissioner, South African Revenue Service v Marshall NO and Others* 2017 (1) SA 114 (SCA)

²⁴ '...For the purposes of this Act a designated entity shall be deemed to supply services to any public authority or local authority to the extent of any payment made by the authority concerned to or on behalf of that designated entity in respect of the taxable supply of goods or services by that designated entity'.

²⁵ <http://ipproducts.jutalaw.co.za.uplib.idm.oclc.org/nxt/gateway.dll?f=templates&fn=default.htm&vid=Publish:10.1048/Enu> (accessed on 03-09-2017)

2.9.4 Exempt Supplies

Exempt supplies are supplies upon which no VAT is leviable.²⁶ Section 1²⁷ of the Act stipulates that an exempt supply is a supply that is exempt from tax under section 12. Under the exempt supplies, it does not matter whether the supplier is a vendor or a non-vendor. The supply is not a taxable supply, so the person making it gets no deduction for the tax paid by him on any goods acquired by him in making the supply.

Section 12²⁸ of the Act contains the list of exempt supplies. Among other things on the list is the supply of financial services, supply made by any association not for gain, the supply of a dwelling under an agreement for the letting and hiring, the body corporate's supply of any of its services to any of its members in the course of its duties as a body corporate and the supply of leasehold land by way of letting.

According to Section 1 of the VAT Act,

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

(a) tax charged under section 7 and payable in terms of that section by-

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

(ii) the vendor on the importation of goods by him; or 11

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

(b) an amount equal to the tax fraction (being the tax fraction applicable at the time the supply is deemed to have taken place) of the lesser of any consideration in money given by the vendor for or the open market value of the supply (not being a taxable supply) to him by way of a sale on or after the commencement date by a resident of the Republic of any second-hand goods situated in the Republic.....

(c) an amount equal to the tax fraction of the consideration in money deemed by section 10 (16) to be for the supply (not being a taxable supply) by a debtor to the vendor of goods repossessed under an instalment credit agreement: Provided that the tax fraction applicable under this paragraph shall be the tax fraction applicable at the time of supply of the goods to the debtor under such agreement as contemplated in section 9 (3) (c)'

In short, input tax is defined as the VAT paid by the vendor when acquiring goods or services in the process of making taxable supplies or for the purposes of making taxable supplies. This means that only VAT vendors are allowed to claim a

²⁶ M Silver and C Beneke op cit at 105

²⁷ Section 1 of the Value Added Tax Act Number 89 of 1991 as amended

²⁸ Section 12 of the Value Added Tax Act Number 89 of 1991 as amended

deduction of their input tax from the Receiver of Revenue. The VAT paid by a person when goods or services are acquired²⁹ by him for the purposes of making other things for example exempt supplies, cannot be claimed as input tax. If, however, the vendor acquired³⁰ the goods or services with the main aim of consumption or use in the making of taxable supplies but in the process, some of the goods are not used in the making of the intended taxable supplies, the vendor is allowed to claim only the portion that has been used in the production of the taxable supplies.

In the circumstances where a vendor acquires goods or services partly for the purposes of making taxable supplies and partly for other purposes, the tax incurred by the vendor is classified as input tax only to the extent that the VAT that such goods or services are used, consumed or supplied in the course of making taxable supplies.³¹ If, however, the goods have been acquired and 95 percent of the goods or services are used to make taxable supplies, then under those circumstances, the goods may be deemed to have been acquired wholly for the purposes of making taxable supplies.

The word acquired has not been defined in the VAT Act, therefore the ordinary meaning of the word must be attributed to it. According to the Cambridge English Dictionary, the word acquire means to get something³². The Oxford English dictionary defines the word acquire as ‘to buy or obtain (an asset or obtain) for oneself’.³³ The ordinary meaning of the word and the context in which it is used in the definition of input tax in the VAT Act does not indicate that it is limited to the ownership or legal title. The requirement that the goods must be acquired for the purpose of making taxable supplies also does not only apply to imports, but applies to local acquisitions of goods or services.³⁴

According to Section 16(5) of the Act, a vendor is supposed to submit a tax return at the end of each tax period. In this return, the vendor deducts their input tax from the output tax for that particular period. In circumstances where the output tax exceeds his input tax, the difference is owed to the Receiver of Revenue, and when the

²⁹ Accordingly the word acquired is not defined in the VAT Act. The word ‘acquire’ is not defined in the VAT Act and therefore the ordinary meaning of the word must be attributed to it in the context of the VAT Act.

³⁰ Gerhard Badenhorst ‘When are goods acquired for purposes of claiming Input Tax’: source TAXtalk 2014, pp 65 - 67 (2014)

³¹ M Silver and C Beneke op cit at 116

³²<http://dictionary.cambridge.org/dictionary/english/acquire> (accessed on 03-09-2017)

³³<https://en.oxforddictionaries.com/definition/acquire> (accessed on 04-09-2017)

³⁴ Gerhard Badenhorst op cit

input tax exceeds the output tax for that particular period, the difference is claimable from SARS by the vendor.

In short, one can say input tax is a tax collected by registered vendors on the value added by them in conducting their business activities. Alternatively, VAT is a type of indirect tax based on consumption of goods and services in the economy. The tax burden of VAT is borne by the final consumer while maintaining neutrality in the business chain.³⁵

2.10 CONCLUSION

The above chapter dealt with the definition of VAT as defined by legal dictionaries and legal scholars as well as the background of the VAT system in South Africa and around the world. It explored the implications of VAT on the South African economy. In the next chapter, the case law on VAT and input tax, as well as the allowable deductions as decided by the courts will be explored.

³⁵[http://www.sars.gov.za/AllDocs/Documents/Small%20business/Value-Added%20Tax%20\(VAT\).pdf](http://www.sars.gov.za/AllDocs/Documents/Small%20business/Value-Added%20Tax%20(VAT).pdf) The mechanism for charging, collecting and paying VAT to the government is based on self-assessment which allows businesses to determine its liability or refund for tax. It allows businesses to deduct the vat incurred on business expenses, which is the input tax, from the VAT collected on the supplies made by the business which is the output tax.

CHAPTER 3 – DISCUSSION OF CASE LAW SURROUNDING THE VAT SYSTEM

3.1 INTRODUCTION

In the preceding chapter, we explored the definition of tax as defined by various dictionaries and legal scholars. One dictionary defined tax as money that must be paid to the state, charged as a proportion of income and profits or added to the cost of some goods and services.¹ Legal scholars like Lymer and Oats² have also defined tax as ‘a compulsory levy, imposed by government or other tax raising body on income, expenditure or capital assets, for which the taxpayer receives nothing specific in return.’

The different types of taxes that are paid to the Receiver of Revenue were also discussed in the previous chapter. Basically, there are two types of taxes which are direct taxes and indirect taxes. Direct taxes are those taxes where the tax burden cannot be moved, for example income tax. Indirect taxes are those taxes where the burden can be shifted to the next person, like the customs duty and VAT. This paper focuses on VAT. The historical background of the VAT system in South Africa and around the world was discussed, beginning with the GST as a form of tax that was replaced by the VAT system in September 1991. Various controversies surrounding the introduction of VAT were also discussed in the previous chapter, as some people were of the view that VAT could not replace the GST as a stable and reliable source of government revenue. The controversies did not hold as the VAT was introduced anyway. Immediately after its introduction, VAT became a huge contributor to the income of the government.

It was also noted that the South African VAT system is regressive in nature. The previous chapter also listed the countries that charge VAT in Africa and in the world as well as the percentages that the various countries charge in the form of a table. The legislation that regulated VAT in South Africa, the Value Added Tax Act was discussed, as well as the requirements to be able to register and become a VAT

¹Waite and Hawker (eds) *Oxford Dictionary & Thesaurus* (2009) 952. According to Oxforddictionaries.com at <http://oxforddictionaries.com/definition/english/tax?q=tax> (accessed on 22/12/2016) a tax is ‘a compulsory contribution to state revenue, levied by government on worker’s income and business profits, or added to the cost of some goods, services, and transactions’.

²*Taxation Policy and Practice* (2009/2010) 3.

vendor, as a person cannot claim an input tax deduction before they are a registered VAT vendor.

The consequences of registering as a VAT vendor were highlighted. If a taxpayer has registered to become a VAT vendor, whether by compulsory or voluntary registration, the vendor is now required by the law to account for output tax to the Receiver of Revenue in respect of all the taxable supplies made by them. Lastly, the various components of VAT in South Africa, namely standard rated tax, zero rated supplies as well as the exempt supplies were discussed.

There were many disputes that were adjudicated by the courts between the Receiver of Revenue and taxpayers on the issue of what can be allowed as a deduction of the taxpayer's input tax. In some instances, the arguments were on the definition of an enterprise itself as taxpayers would query the assessments that they would have received.

In this chapter, we explore various cases that were reported on the relationship between input tax and taxable supplies, as well as the judgments that were delivered on those cases. South African cases will be discussed, as well as a few European cases as the systems are similar when it comes to input tax. We adopted our input tax principles from European countries, thus the similarity in principles.

3.2 *ITC 1744 (65 SATC 154)*

In this case, the principle that was brought out was that an input tax deduction can only be claimed if the expenditure was incurred in the making of taxable supplies by the vendor. This means that the vendor cannot claim an input tax deduction if he used the money for some other activities that relate to the business, but not in the actual making of taxable supplies. Further, the principle that financial services are exempt supplies as stipulated by Section 2 (1) (d) means the vendor cannot claim an input tax deduction on exempt supplies.

3.2.1 *Facts of the case*

In the *ITC 1744 (65 SATC 154)*³ case, the appellant was a registered VAT vendor in the business of manufacturing steel shipping containers suitable for road freight. The appellant did not have capital to start the business and hired the services of a company specializing in the venture capital market. The appellant remunerated the hired company and sought to claim the VAT it paid on the remuneration from the Receiver of Revenue on the basis of it being an input tax deduction.

3.2.2 *The arguments raised by the parties*

The Receiver of Revenue rejected the claim and based this rejection on Section 2(1) (d) of the Act⁴ in which the allotment, issue and transfer of equity securities is considered as financial services and financial services are exempt from tax as stipulated in Section 12(a) of the Act.⁵ Further, the commissioner argued that this tax as levied, in terms of Section 7 of the Act,⁶ cannot be claimed as it is exempt.

In addition, the commissioner relied on the definition of input tax as contained in section 1 of the Act to reject the appellant's claim. According to the definition, input tax is the tax which the vendor himself has incurred in respect of goods or services supplied to him and where the vendor acquires the same wholly and partly for the purposes of making taxable supplies. They gave a further reason that the VAT charged on the supplies of those goods or services will qualify wholly or partly as an input tax deduction.

In argument, the appellant contended that although the supply of financial services was exempt from VAT, its claim for input tax should be allowed because of the close connection between the sale of shares and the shipping containers

³ Income Tax Case No 1744

⁴ 'For the purposes of this Act, the following activities shall be deemed to be financial services... the issue, allotment, or transfer of ownership of an equity security or a participatory security;'

⁵ 'The supply of any of the following goods or services shall be exempt from the tax imposed under Section 7 (1)(a):

(a) The supply of any financial services,'

⁶ Section 7 of the Value Added Tax Act 89 of 1991 "

manufactured by which it would not have been so manufactured if the capital had not been raised by the company that it hired. This, the appellants argued, brought the VAT paid on those services offered by the company within the definition of input tax as stipulated in Section 1 of the Act as the services were acquired wholly for the purposes of consumption, use or supply in the course of making taxable supplies.

3.2.3 *Court's ruling and the reasons thereof*

The court held that although the raising of capital was indispensable to the making of taxable supplies, the raising of same seemed rather to be of a preparatory nature such that one cannot conclude that the services of the company so employed were engaged for the purposes of making taxable supplies.

It was also held that where goods or services are used for an exempt supply, it is not necessary to look through the supply to connect it to the carrying out of a taxable supply. The Appellant was denied from claiming an input tax deduction on the amount it had paid for the services in question.

The court contended that the services of the company hired were financial services which are exempt from tax in terms of the Act. Further, the court reasoned that Section 17 of the Act reinforces the definition of input tax by providing that where services are obtained by a vendor partly for use in making taxable supplies and partly for personal use, input tax is claimable in respect of supplies by the vendor which are taxable. To this extent, the appellant's activities did not amount to the carrying on of an enterprise as stipulated by the Act, therefore his activities fell outside the services described in the input tax bracket.

From this case, it can be noted that there has to be a sufficiently close connection between the amount claimed as input tax and the taxable supply. The court rightly ruled that the connection between the services acquired and the type of business that was being carried on by the appellant of manufacturing steel shipping containers suitable for road freight was too distant, hence the claim was disallowed.

Further, when a taxpayer acquires services that are exempt from tax, they cannot then expect an input tax deduction as the services that they would have acquired would

have been exempt supplies. The services that had been acquired were of a financial nature and are exempt from tax, so the Appellant should not have expected to obtain an input tax deduction on such a transaction.

3.3 ITC 1853 (73 SATC 293)

In this case, the principle of input tax that was at issue was on whether services provided by local and international service providers, acquired by a company that is legally mandated to do so, can be exempted from paying tax.

3.3.1 *Facts of the case*

In the *ITC 1853 (73 SATC 293)*⁷ case, the appellant, De Beers Consolidated Mines Ltd (DBCM) was a vendor listed as a public company on the Johannesburg Stock Exchange, the London Stock Exchange, as well as the Swiss Exchange in the business of mining and selling diamonds. The vendor considered and approved a consortium where some of its shareholders would buy out shares and in the process, hired the services of foreign and local service supplies as it was legally mandated to do so.

The respondent, SARS, did not allow an input tax deduction on the VAT charged by the local suppliers in respect of the local services. The commissioner also charged VAT on the services paid for by the vendor for the foreign services so acquired on the basis that they were foreign services.

The appellant lodged an objection against the assessments by the respondent. The respondent refused to deduct the input tax as claimed and the appellant lodged an application to the tax court for adjudication. The tax court upheld the appeal, resulting in the Respondent's assessments being set aside.

3.3.2 *Court's ruling and reasons of the Court's Judgment*

⁷Income Tax Case Number 1853

With regards to the imported services, the court ruled that if the transaction has a direct link with the organisation's activities, then the transaction would be considered as a transaction that is necessary in the activity of the appellant and would thus be within the definition of VAT and would be claimable as an input tax deduction.

As to the local services, the court held that the appellant had to show that the services had been acquired for the purposes of making taxable supplies if it were to succeed in its claim for an input tax deduction. In this case, the appellant had not done much to convince the court and produce evidence that the services of the local suppliers were wholly acquired for the purposes of the furtherance of its business, thus making taxable supplies. The court ruled that there should be an apportionment and referred this matter back to the respondent to determine what portion of the services and amount was to be allowed as an input tax deduction. The court ordered that the penalty that had been imposed by the respondent on the appellant be set aside and gave the parties leave to appeal the judgment.

The matter was taken on Appeal to the Supreme Court of Appeal,⁸ with the leave of the tax court, by the respondent, the commissioner for the Receiver of Revenue and De Beers Mining Company which was the appellant in the tax court cross-appeal. The court upheld the appeal with costs of both counsels and dismissed DBCM's cross appeal.

3.3.3 *Arguments raised by the parties*

The company argued that, as the NMR Consulting services were consumed outside of South Africa, they could not be found to be imported services and therefore should not attract VAT. At least, so the argument went, the advice that was given at meetings held outside of South Africa could not be categorised as imported services. Furthermore, they contended that the provision of the services by NMR were necessarily attached to and accordingly a concomitant of their mining and commercial enterprise as a public company. The services were rendered in fulfilling their statutory obligations as a public company, were therefore directly linked to the making of ongoing supplies and, so it was argued, could therefore not fall within the definition of imported services.

⁸<http://www.saflii.org/za/cases/ZASCA/2012/103.pdf> accessed 20/02/2017

On the other hand, the commissioner was of the view that the purpose of the acquirer of the service should be looked at. The commissioner argued that the purpose of acquiring the services of NMR was to obtain advice relating to a takeover by the parties involved. It was argued further that the advice so acquired was to benefit the outgoing shareholders. The commissioner urged the court to take into account the features of how the transaction was structured and implemented. The commissioner contended that if this was done, NMR's services would be seen to be unrelated to the core business activities of the mining company.

3.3.4 *Court's Judgment*

On appeal, the Supreme Court found the submissions of the commissioner to be correct. The court interpreted the legislation in question to the facts before it. It found NMR's services not to be related to DBCM's core business activities. Numerous facts were considered by the court and it reached a conclusion that NMR's services were consumed in South Africa.

On local services obtained by DBCM, the court ruled that they could only be seen as a necessary input and the following three questions arose: Were the local services acquired by DBCM for the purpose of consumption, use of supply in the course of making taxable supplies? Secondly, were the services acquired wholly for that purpose? If the answer was positive, but not wholly, to what extent were they acquired for such purpose? The court found that the local services for example those of Webber Wentzel Bowens (WWB), a law firm which gave legal advice from the transaction's inception, to be instrumental to certain aspects of the transaction. The same reasoning applicable to NMR's services applied to the services rendered by the other local service providers. These services were also found to have been acquired for the purpose of dealing with the proposal in question and did not qualify for input tax deductions.⁹

I agree on the judgment of the Supreme Court. The transactions of the vendor seem too far-removed from its business of mining and selling diamonds. Although legally mandated to obtain the services of the consultants and all those other services

⁹<http://www.saflii.org/za/cases/ZASCA/2012/103media.pdf> accessed 03/03/2017

the company employed, it does not mean that there will be an automatic input tax deduction on the services so obtained as required by legislation from a public company. If the services were so linked to the mining of diamonds which was the activity of the vendor, then the vendor would have been allowed to claim a deduction of the input tax. This judgment highlights the fact that there should be a sufficiently close connection between the expenditure concerned and the enterprise of the vendor to allow a deduction of input tax.

3.4 *COMMISSIONER OF CUSTOMS V REDROW GROUP PLC*

3.4.1 *Facts of the case*

In international law, the English case of the *Commissioner of Customs v Redrow Group PLC: HL* 11 February 1999¹⁰ is worth noting. In this case, the taxpayer was a company, Redrow Group (RG), which built houses for sale. The taxpayer operated an incentive scheme where it agreed with both the prospective purchaser and the prospective purchaser's estate agent that it would pay the estate agent's fees on the sale of an existing home, including the VAT, if the prospective purchaser successfully purchased a house from the taxpayer. RG would select and instruct the estate agent and continue to apply pressure on the agent to sell a house. RG would then claim to be entitled to deduct as input tax the value added tax that would have been charged by the estate agent on their fees. In doing this, RG relied on the English legislation, section 14(2) of the Value Added Tax 1983,¹¹ as amended. Section 14(2) provides as follows:

'....(2) subject to the provisions of this section, he is entitled at the end of each such period to credit for so much of his input tax as is allowable under section 15 below, and then to deduct that amount from any output tax that is due from him.'¹²

¹⁰<http://login.westlaw.co.uk.uplib.idm.oclc.org/maj/wluk/app/document?src=doc&linktype=ref&context=89&crumb-action=replace&docguid=I935F3A40E42711DA8FC2A0F0355337E9> . Accessed 30/03/2017

¹¹<http://www.legislation.gov.uk/ukpga/1983/55/contents>. Accessed 30/03/2017. This Act has now been repealed and replaced by the Value Added Tax Act 1994.

¹²<http://www.legislation.gov.uk/ukpga/1983/55/section/14/enacted>. Accessed 30/03/2017

The main issue which had to be decided in this case was whether the tax which RG paid to the estate agent fell within the definition of input tax in Section 14(3)¹³ as amended.

The commissioner disallowed the deduction by RG, resulting in RG appealing to the VAT Tribunal against the decision of the commissioner which held that the services supplied by the estate agents had been supplied to both the taxpayer and to the prospective purchasers. On appeal by the commissioner, it was held that the tribunal had been entitled to reach that decision and therefore allowed an appeal by the commissioner.

3.4.2 *Court's ruling and the reasons for the ruling*

In allowing the appeal, the court held that it was not necessary for there to be a direct and immediate link between the services supplied by the estate agents and the sale of a particular house. It was held further that the recipient of the services was to be identified by first looking at the matter from the taxpayer's point of view and

'...asking whether he had obtained something used or to be used in his business in return for the payment of which the value added tax sought to be deducted as input tax formed part; that the fact that someone else also received a service as part of the same transaction did not deprive the taxpayer of the right to deduct the tax; and that, since the taxpayer company had, in those cases where it had become liable to pay the estate agents' fees, obtained something of value for the purposes of its business, it was entitled to deduct the value added tax as input tax.'¹⁴

¹³“Subject to subsection (4) below, "input tax ", in relation to a taxable person, means the following tax, that is to say

(a) tax on the supply to him of any goods or services ; and

(b) tax paid or payable by him on the importation of any goods,

being (in either case) goods or services used or to be used for the purpose of any business carried on or to be carried on by him ; and " output tax " means tax on supplies which he makes.”

¹⁴<http://login.westlaw.co.uk.uplib.idm.oclc.org/maj/wluk/app/document?src=doc&linktype=ref&context=89&crumb-action=replace&docguid=I935F3A40E42711DA8FC2A0F0355337E9>. Accessed 31/03/2017.

The court of final appeal ruled that the previous court had erred in its interpretation of the BLP case. The BLP case was about the attribution rather than the identity of the person to whom the goods were supplied, making the argument irrelevant to this case. It was held that the starting point was to determine the taxpayer's claim to deduct input tax and whether he had obtained anything to be used in his business. Although that would usually consist of a supply of goods or service to the taxpayer, it could also consist of the right to have goods or services rendered to a third party and that would also, in itself, be a supply of services.

Further, the court held that those requirements had been met by RG as it had not only derived a benefit from the services supplied by the agents to the purchasers, but the acts done by the agents, which were done at RG's instruction and expense amounted to a supply of services. The court came to a conclusion that there should not necessarily be a direct and immediate link between the agents' services and the sale of a certain one of RG's homes.

The interpretation of the court of the Act in this instance can make a way for taxpayers not to pay tax. This will mean that there needs not be an immediate link between the service that would have been derived, which is the benefit, and the taxable supply which the taxpayer is offering. It means the taxpayers will have to look through the service in search of who benefitted and the original intention of the service. In this case, the service of the agent was a bit out of line with the enterprise of RG as RG's main line of business was the selling of houses. All that comes on the side of pushing that the sales should be charged VAT.

3.5 BLP GROUP PLC V CUSTOMS AND EXCISE COMMISSIONERS (C – 4/94)

3.5.1 *Facts of the case*

In another European case of *BLP Group PLC v Customs and Excise Commissioners*,¹⁵ an input tax deduction was at issue on whether the VAT charged by a financial advisor who gave the advice on the sale of shares, was claimable as input tax. The facts of the

¹⁵(C – 4/94)[1996] 1 WLR 174 ECJ

case were as follows: In the year 1989, BLP sold its shares in a certain company called BMG. BLP was the majority shareholder in BMG Company. In its VAT return for that year, BLP sought to claim the VAT that it had paid on the professional services it had received in respect of the share sale. The sale of shares was a tax exempt transaction.

The court ruled that where a taxable person supplied services to another taxable person who used the services for an exempt transaction, the person who used them for exempt supply cannot later claim an input tax deduction on the service even if the ultimate purpose of the transaction was the carrying out of a taxable transaction.

3.6 *SOUTH ATLANTIC JAZZ FESTIVAL (PTY) LTD V CSAR*

In the South African case of *South Atlantic Jazz Festival v CSAR*¹⁶ the principle at issue was whether a supplier's failure to issue an invoice despite being demanded to do so by the vendor, prevents the vendor from claiming input tax deduction according to the Act.¹⁷

3.6.1 *Facts of the case*

The facts of the case were as follows: The appellant in this case was the South Atlantic Jazz Festival. This case was on appeal in the Western Cape High Court. The appellant organised international jazz festivals once a year. The appellant would conclude sponsorship contracts with various other VAT vendors among others South African Airways, City of Cape Town, Telkom and the South African Broadcasting Corporation, hereinafter collectively referred to as the sponsors.

In terms of these contracts, the sponsors would pay some money and provide goods and services for the festival and the appellant would provide branding and marketing services to the sponsors at the festival¹⁸.

¹⁶*South Atlantic Jazz Festival (Pty) Ltd v CSARSD* – HCA 129/2014 WC 6 February 2015.

¹⁷ Section 20 (7) or 16 (2) (f) of the VAT Act.

¹⁸ <http://www.thesait.org.za/news/226462/South-Atlantic-Jazz-Festival-Pty-Ltd-v-CSARS--HC-A1292014-WC-6-February-2015.htm>

The appellant was supposed to declare and pay output tax on the goods and services provided by the sponsors, but did not do so. This was identified in a tax audit and this resulted in a tax assessment issue.

The matter that was at issue was whether the appellant is entitled to offset the output tax liability with the input tax deduction in respect of the supplies made by the sponsors. The commissioner had declined any input tax deduction.¹⁹ The commissioner and the tax court denied that the appellant should claim input tax on the supplies. The commissioner's grounds for the denial were that the taxpayer was not in possession of a valid tax invoice. The tax court held that the appellant should have created its own tax invoices due to the failure by the sponsors to supply tax invoices, despite demand.

The high court had to decide whether the provisions of either section 20(7)(b)²⁰ or 16(2)(f)²¹ of the VAT Act should have been applied to allow the appellant to deduct the input tax as a result of the sponsors' failure to issue tax invoices to the appellant.

The court held that the commissioner should be satisfied that there must be an existence or availability of documentary proof and that it would not be practical to require a full tax invoice to be issued before the commissioner could direct that no tax invoice was required to be issued. The court accepted that the contracts entered into between the sponsors and the appellant constituted sufficient proof or documentary evidence. The court further held that it would have been impractical for the sponsors to issue full tax invoices for the goods they had provided and the services that they rendered.

3.6.2 *Court's Ruling*

¹⁹http://c.ymcdn.com/sites/sait.site-ym.com/resource/resmgr/2015_SARS_-_April/LAPD-DRJ-HC-2015-02_-_South_.pdf

²⁰Where the Commissioner is satisfied that there are or will be sufficient records available to establish the particulars of any supply or category of supplies, and that it would be impractical to require that a full tax invoice be issued in terms of this section, the Commissioner may, subject to such conditions as the Commissioner may consider necessary, direct—

...

(b) That a tax invoice is not required to be issued, or ...'

²¹ 'No deduction of input tax in respect of a supply of goods or services, the importation of any goods into the Republic or any other deduction shall be made in terms of this Act, unless –

....

(f) the vendor, in the case where an amount is deducted from the sum of the amounts of output tax which are attributable to that period in terms of subsection (3)(c), (d), (dA), (e), (f), (g), (h), (i), (j), (k), (l), (m), or (n), is in possession of documentary proof, as is prescribed by the Commissioner, substantiating the vendor's entitlement to the deduction at the time a return in respect of the deduction is furnished'

The court upheld the appeal, resulting in the order of the tax court being set aside. Further, the court ruled that the additional assessments that had been made be set aside and the assessment referred back to the commissioner for reconsideration. The court accepted the argument on behalf of the applicant that the sponsorship contracts were sufficient records of the supplies that were made.²² It was mentioned that it was the commissioner's duty to compel the issue of the invoices if they needed them. In this case, the principle that was developed is that in certain circumstances, the absence of a proper invoice should not automatically mean that the tax assessments should be raised. The commissioner must satisfy himself with all the available documentation and find out if the documents would not qualify as sufficient documentation as required by section 20(7)(b) read together with section 16(2)(f) of the VAT Act.

3.7 *SHELL'S ANNANDALE FARM (PTY) LTD V COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE*

The principle that was developed in this case was whether the high court can issue declaratory orders in respect of tax matters, in particular the payment of VAT by a vendor on the expropriation of the vendor's land.

3.7.1 *Facts of the case*

In the South African case of *Shell's Annandale Farm (Pty) Ltd v Commissioner for the South African Revenue Service*, the taxpayer approached the court for a declaratory order on a matter of expropriation of land.²³ The facts of the matter were as follows: The taxpayer was a VAT vendor who was registered in terms of the VAT Act 89 of 1991 and was in the business of leasing agricultural land on which farming operations would be performed by the lessee. In 1993, the vendor received a letter from the Provincial Administration of the Cape informing him that it had been decided that the land belonging to the vendor had to be expropriated by the Provincial Administration of the Cape for the purposes of establishing a settlement to provide low cost residential

²²http://c.ymcdn.com/sites/sait.site-ym.com/resource/resmgr/2015_SARS_-_April/LAPD-DRJ-HC-2015-02_-_South_.pdf.7

²³*Shell's Annandale Farm (Pty) Ltd v Commissioner for the South African Revenue Service* (62 SATC 97)

accommodation. After some negotiations, the parties agreed the price to be paid to the taxpayer for the land as well as the solatium on the inconvenience.

Four years after the transaction, the taxpayer received a letter from the commissioner of the Receiver of Revenue claiming VAT on both the compensation and the solatium received on the expropriation of the taxpayer's land. In that letter, the commissioner stated that unless good reasons were shown, penalties and interest would be levied from the date of expropriation on the outstanding amounts.

The taxpayer denied that he was liable for VAT in respect of the compensation and the solatium received. After obtaining the necessary advice, the taxpayer approached the High Court of the Western Cape for a declaratory order that the taxpayer was not liable for the VAT.

The court had to deal with two issues. First, the commissioner argued that the applicant was precluded from applying for the relief he sought from the high court, so the court should refuse to entertain such an application. Secondly, the applicant contended that no act was performed by him which gave rise to the expropriation of the applicant's land. The applicant just received the notice of expropriation and had thus not performed any supply, so the proceeds of the expropriation were not subject to VAT.

3.7.2 *Court's ruling*

On the first point raised by the respondent on the high court's jurisdiction to hear the matter and issue a declaration, the court ruled in favour of the applicant and exercised its discretion, as the matter is one that has a dispute on law not on facts. The court also declared that the applicant was not liable for VAT in terms of the Value Added Tax Act 89 of 1991. In this case, one can note that VAT was not applicable as there was no supply in the legal sense of the word. In an expropriation transaction, the person whose land is being expropriated is not liable to pay VAT. This applies to all the other cases where the taxpayer has not performed an act or a supply as defined by the VAT Act.

3.8 COMMISSIONER, SOUTH AFRICAN REVENUE SERVICES V PRETORIA EAST MOTORS (PTY) LTD.

The principle that was developed in this case was that where the taxpayer fails to provide sufficient documentation, the Commissioner may disallow the input tax deduction based on the absence of proper proof to that effect.

3.8.1 *Facts of the case and the Court's Judgment*

In the *Commissioner, South African Revenue Services v Pretoria East Motors (Pty) Ltd*²⁴ case, the facts were as follows: The respondent, Pretoria East Motors (Pty) Ltd, was an authorised Toyota South Africa dealer who sold cars and had opened dealerships at Menlyn and Garsfontein in Pretoria.

In June and July 2003 the authorised officials who were employed by the appellant, the commissioner for the South African Revenue Services, conducted a detailed audit of the tax affairs of the taxpayer for the period 2000 to 2004. As a result of the audit, various additional income tax and VAT assessments were raised by the commissioner. Although the assessments themselves were omitted from the record it appears that there were additional assessments for income tax in respect of each of 2000, 2001 and 2002 and other additional VAT assessments, respectively for 2000, 2001, 2002, 2003 and 2004. The taxpayer's objection to those assessments was disallowed by SARS. The taxpayer then appealed to the special tax court in Pretoria and the tax court upheld some of the assessments by SARS. This case dealt with aspects of income tax and VAT but only the VAT aspects will be discussed in this chapter.

In this case, the parking lot which was rented by the taxpayer was considered as necessary and thus an unavoidable expense in the making of taxable supplies of the taxpayer, but the taxpayer had failed to prove part of the money that he had paid as rentals for the parking had actually been paid for parking. The taxpayer had paid the money in cash so, based on the judgement; the Court referred the matter back to the commissioner for reassessment.

²⁴*Commissioner, South African Revenue Services v Pretoria East Motors (Pty) Ltd* 2014 (5) SA 231 (SCA).

3.9 RTCC V COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE

In the recent judgement of *RTCC v Commissioner for the South African Revenue Service*,²⁵ the facts of the case were as follows: RTCC was a company which was in the business of offering courier services. During an audit conducted by the respondent, the claim for a Mercedes Benz Vito motor vehicle was disallowed by the respondent based on the fact that it was a motor vehicle. The appellant requested that the input tax it paid on purchasing the motor vehicle be allowed to be deducted as an input tax deduction as the motor vehicle was used solely for the making of taxable supplies, that is, the transportation of goods.

On appeal to the tax court, the court confirmed that the motor vehicle was indeed a motor vehicle so the input tax deduction was to be disallowed. The court, in giving its judgment relied on the Interpretation Note 82 dated 25 March 2015²⁶ which provides that an objective test must be used in order to determine the use of a motor vehicle. The interpretation note further stipulates that the purpose for which the motor vehicle was actually used is irrelevant to the determination of whether to allow the input tax deduction or not.

3.9 CONCLUSION

This chapter discussed the South African as well as the European case law on input tax as it relates to taxable supplies. It can be noted that various factors are considered before a transaction can qualify for an input tax deduction. Further, it is important to consider the nexus between the transaction and the taxable supply, as well as relevant legislation before claiming for same from the Receiver of Revenue. If the transaction is not close to the making of taxable supply, the Receiver of Revenue may refuse to allow the input tax claim.

²⁵*RTCC v Commissioner for the South African Revenue Service* (VAT 1345) [2016] ZATC 5 (28 July 2016)

²⁶ ‘...the test in determining whether a vehicle has been constructed wholly or mainly for the carriage of passengers is an objective one ...Factors considered to be irrelevant and not influencing the aforementioned objective test include the – (A) classification of the vehicle for licensing purposes; (B) purpose for which the vehicle is actually used; or (C) purpose for which it was acquired’ p 4

Above all, it can be noted that each case is dealt with according to its own merits. There is not a single standard that can be used to cater for all the facts, but as cases arise, the courts are approached and new principles are developed.

CHAPTER 4 – CONCLUSION

4.1 INTRODUCTION

This chapter is the conclusion of the research paper which discussed the relationship between input tax and taxable supplies according to the VAT Act. It provides a summary of all the chapters that were discussed in this paper. This chapter will further provide answers to the problem statements that were intended to be answered by this paper. In addition, this chapter will give recommendations on the legislative changes that need to be made to the South African VAT Act after discussing the position as it is.

4.2 SUMMARY OF PREVIOUS CHAPTERS

4.2.1 *Chapter 1*

The first chapter introduced the subject matter of this research paper. It gave the general background to the VAT system in South Africa after its introduction in South Africa for the first time in September 1991 at 10 percent before being increased to 14 percent. Being the tax that is charged on each transaction in the production and distribution chain of a manufactured product, there are usually problems that are encountered in the process of collecting VAT on behalf of the National Revenue Fund. The final consumer bears the tax burden as the businessmen who would have sold the goods will claim their input tax from the Receiver of Revenue.

The first chapter also discussed the procedure of claiming the tax from the Receiver of Revenue which is the difference between the input tax and the output tax paid by the vendor due to SARS. In circumstances where the output tax paid by the vendor exceeds the vendor's input tax, the vendor has to pay the difference to SARS and if the input tax exceeds the vendor's output tax, it is Receiver of Revenue who pays the difference to the VAT vendor.

A brief discussion of the key terms in the Value Added Tax subject were discussed, that is, the input tax, output tax, VAT vendor supply and enterprise. The purpose of this study was to analyse the relationship between input tax and the taxable supplies for the purpose of claiming the difference from SARS

4.2.2 *Chapter 2*

The second chapter dealt with an in depth definition of tax as well as the key terms such as the types of taxes like direct and indirect taxes. The history of the VAT system in South Africa was discussed together with its evolution from the GST and how it was applied in South Africa and the introduction of the VAT system which was met with a high level of criticism from analysts. The other countries in the world that charge VAT were discussed with the aid of charts, as well as the VAT that they charge on goods and services. The overarching aim of the chapter was to start the investigation into the relationship between input tax and taxable supplies by defining the concepts as they are used in the tax field.

4.2.3 *Chapter 3*

In chapter 3, the case law surrounding the VAT system of taxation, in particular the input tax was discussed. Various cases, both South African and European, were explored with the aim of analysing the relationship between input tax and taxable supplies and exploring how various principles were developed by the courts.

In this present chapter, I conclude the research paper by answering the problem statements that were identified in the first chapter and were meant to be answered. This chapter also concludes by suggesting what needs to be done to improve the South African VAT collection system in order to help with the collection of the money due to the Receiver of Revenue. This will be done after giving a brief summary of the legal position as it is in the South African legal system, as reflected in legislation and case law.

4.3 ANSWERS TO THE PROBLEM STATEMENTS

To begin with, the question of whether there is an acceptable relationship between the supply and the input tax does not have a definite answer. The reason is that each case was adjudicated according to its own merits. Generally, there has to be a very close nexus between the supply and the input tax claimed from the Receiver of Revenue, otherwise SARS will reject the claim. This was highlighted in the case of *ITC 1744 (65 SATC 154)*¹ where it was decided that if the input tax claimed is remotely connected to the actual enterprise carried on by the VAT vendor then the input tax deduction claimed by the vendor may be disallowed.

Secondly, it can be noted that the principle that was developed is that the expenditure to which the input tax deduction is being claimed must have been in the actual furtherance of the vendor's enterprise. If it was partly used for the furtherance of the vendor's enterprise and partly for his personal use, then there has to be an apportionment of the input tax that has to be deducted.

In South Africa, the procedure on claiming an input tax deduction from the Receiver of Revenue was stipulated in the Value Added Tax Act. The relationship is further being clarified by the courts through decided cases where the parties approach the court because legislation is not clear on their cases or because of a dispute on law or facts.

The procedure of submitting invoices when claiming for an input tax deduction as well as the SARS audit, when necessary, are the measures that have been put in place to prevent the vendors from claiming more than what they are supposed to claim. Further, the process of apportionment of input tax allows the Receiver of Revenue to disallow the input tax on supplies that have been used partly for making taxable supplies and partly for personal use.

4.4 CONCLUSION

In South Africa, the legislature must look at the relationship between the taxable supplies and the input deduction and compile an interpretation note on that part of the legislation as there is no consistency in the deduction of input tax which was incurred in

¹ Income Tax Case No 1744

the making of taxable supplies. This will provide clarity to laymen on how to claim and avoid further disputes with the Receiver of Revenue. Currently the position is not clear as to what the accepted relationship is, so an interpretation note would be beneficial to the general vendors in South Africa.

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