

# UNIVERSITY OF THE WITWATERSRAND, JOHANNESBURG



A research report submitted to the faculty of Commerce, Law and Management in fulfillment of the requirements of a Master's of Commerce (Taxation)

## Value-Added Tax and Financial Services

Applicant:	Jared Lebos
Student Number:	367240
Supervisor:	Prof A P De Koker
Head Of Program:	Prof A P De Koker
Head Of School:	Prof N Padia
Degree:	Master Of Commerce (Taxation)
Date:	March 2017

## Declaration

I declare that this research report is my own unaided work. It is submitted for the degree of Master of Commerce in the University of the Witwatersrand, Johannesburg. It has not been submitted before for any other degree or examination in any other university.



---

Jared Lebos



# Dedication Acknowledgements

This work is dedicated to;

my father who's interest and knowledge of the subject provided the direction of this report;

my mother who's unwavering support during the writing of this report was invaluable;

and my brother who's extensive knowledge and experience in financial services provided a much needed source of theoretical knowledge and the application thereof in the financial sector industry.

A sincere thank you to all of you for your support.

## Acknowledgements

Thank you to Professor Alwyn De Koker for guidance and support during the writing of this report and for providing an extract of his work as the basis on which this report has expanded. Thank you to Professor Michael Honiball and Mr Gerard Badenhorst who's valued input was key to the completion of this report.



# Abstract

Value-added tax (VAT) and similar taxes known as General Sales Tax (GST) are indirect taxes which are currently levied in over 150 countries world-wide. The republic of South Africa (South Africa) introduced VAT through the enactment of the Value-added Tax Act 89 of 1991. Financial services are exempt, by the Value-Added Tax Act 89 of 1991, largely due to the South African VAT system being based on the New Zealand GST system. It is generally accepted that in theory financial services should be subjected to Value-Added Tax.

This study will outline the VAT effects of certain common financial services and how financial service providers may account for the related input and output tax. Additionally the application of the VAT Act against some of the more complex financial arrangements, including new financial instruments that have gained popularity with the increased availability to technologies such as the internet, will also be examined.

This report is limited to the application of the VAT Act only and does not consider other fiscal legislation and its interaction with the VAT Act in this regard.

## Key Words

Value-Added Tax, Financial Services, Exemptions, Complex Financial Arrangements



# **Table of Contents**

<b>Table of Acronyms</b>	<b>7</b>
<b>Introduction</b>	<b>8</b>
Summary of the South African VAT system	8
Object of this research	11
Significance of this research	12
Chapter outline	13
<b>Chapter 1 - The Exempting of Financial Services</b>	<b>15</b>
The Legal Framework	20
<b>Chapter 2 – The meaning of the word ‘Fee’</b>	<b>29</b>
<b>Chapter 3 - Common Financial Services Provided</b>	<b>37</b>
Loan Intermediation and Lending Transactions	37
Finance Leases and Rentals	39
Sundry Services	41
Reverse Charges	43
Direct Loan Services	46
Shares	47
Securities Lending	51
Debentures and Debts	52
Collective Investment Schemes	57
Derivatives	59
Long-term Insurance Policies	61
Ancillary Services	62
<b>Chapter 4- Input Tax</b>	<b>64</b>
Apportionment for Financial Loan Intermediaries	70
Apportionment for Input Tax – Direct Loan Services	74
<b>Chapter 5 - VAT In A Web of Transactions</b>	<b>76</b>
<b>Chapter 6 - Complex Financial Arrangements</b>	<b>80</b>



Syndicated Loans	80
Commitment and Raising Fees	85
Profit participations	86
Sale or Repossession of Property as a Result of Default	91
Credit Guarantee	96
Credit Insurance	97
<b>Chapter 7 – 21<sup>st</sup> Century Financial Services</b>	<b>99</b>
Crowd Funding	99
Peer-to-Peer Lending	101
Cryptocurrency	103
<b>Conclusion</b>	<b>107</b>
<b>Annexure A - Synopsis of South African Statutory Interpretation</b>	<b>111</b>
The text based approach:	111
The text in context approach	113
Constitutional supremacy	115
The interpretation clause	117
Practical, inclusive method of interpretation (Du Plessis)	118
The judgment of Natal Joint Municipal Pension Fund v Endumeni Municipality	120
<b>Annexure B - Calculation of interest as per the national credit act ..</b>	<b>125</b>
<b>References</b>	<b>127</b>
Articles Online	127
Case Law	127
Acts of the Parliament of the Republic of South Africa	129
Republic of South African Government Gazette	130
Explanatory Memoranda	130
Journals	130
Commentary	130
Reports	131



Reference books	131
Financial Statement Extracts	132
Sundry	132
<b>Legal Acronyms and Abbreviations</b>	<b>134</b>



## Table of Acronyms

Acronym	Meaning
ATM [Machine]	Automatic Teller Machine
B2B	Business-to-Business
B2C	Business-to-Consumer
BASA	Banking Association of South Africa
EBIT	Earnings Before Interest and Tax
EBITDA	Earnings Before Interest, Tax, Depreciation and Amortization
ECA	Export Credit Agency
ECIC	Export Credit Insurance Corporation of South Africa
EU	European Union
GST	General Sales Tax
I.T.	Information Technology
IAS	International Accounting Standard
ICA	Installment Credit Agreement
IFRS	International Financial Reporting Standard
LIBOR	London Inter-Bank Overnight Rate
P2P	Peer-to-Peer
SARS	South African Revenue Service
US LIBOR	United States Dollar London Inter-Bank Overnight Rate
USA	United States of America
VAT	Value-Added Tax
VATCOM	Value-Added Tax Committee
ZAR or R	South African Rand





# Introduction

Value-added tax (VAT) and similar taxes known as General Sales Tax (GST) are indirect taxes which are currently levied in over 150 countries world-wide.<sup>1</sup> As a tax system, VAT has its origins in France in the form of excise largely levied on the poor. It was first introduced in 1948 and spread to Western Europe, Asia, the Pacific, Eastern Europe, Africa, North America (except the USA<sup>2</sup>) and South America.

VAT came into effect in South Africa in terms of the Value-added Tax Act 89 of 1991 (“the VAT Act”) on 30 September 1991. The VAT Act was primarily based on the New Zealand GST legislation, namely the New Zealand Goods and Service Tax Act of 1985. Prior to its introduction, the South African government had launched an in-depth study on the various VAT systems in use globally, and this resulted in the selection of New Zealand’s invoice-based VAT system as being the most appropriate for South African<sup>3</sup> adoption. At the time of its introduction, the standard VAT rate was 10% increasing to the current standard VAT rate of 14% with effect from 7 April 1993.

## Summary of the South African VAT system

South Africa applies an invoice-based credit method of VAT with relatively few exemptions, zero-ratings and exclusions. South African VAT is a ‘destination based’ tax system meaning that exports are generally zero rated and imports are taxable. At the time of the enactment of VAT most countries utilised a destination based tax system and with

---

<sup>1</sup> KPMG GLOBAL INDIRECT TAX SERVICES The 2013 Benchmark Survey on VAT/GST

<sup>2</sup> United States of America

<sup>3</sup> Report of the Value-Added Tax Committee (VATCOM), Republic of South Africa 1990



ever increasing global trade, an origin based tax system would result in exports being taxed both in South Africa and in their destination country. This double tax would result in South African exports being uncompetitive internationally.

Prior to the introduction of VAT in South Africa, the prevailing view was that theoretically there appeared to be no reason why financial services should not be subject to VAT.

‘In theory, there does not appear to be any reason why financial services should not be subject to VAT. Financial services are a consumption expenditure just like any other service and in fact, because they form a higher proportion of budgets of higher income households there is every reason to subject them to VAT.’<sup>4</sup>

When VAT was enacted in 1991,<sup>5</sup> however, South Africa followed the New Zealand GST methodology and most domestic financial activities and exported financial services were deemed to be financial services<sup>6</sup> and exempt from VAT or zero-rated. The list of deemed financial services was substantially expanded when the supply of goods or services necessary for or incidental to the supply of financial services was added.<sup>7</sup> Commencing in 1996, the scope of exempt financial services was reduced to exclude from the exemption all domestically rendered, fee-based financial services,<sup>8</sup> which lessened the amount of blocked input VAT, but did not eliminate the need to allocate input tax between taxable and exempt supplies.

The South African Revenue Service (SARS) engaged with the banking industry and developed a comprehensive list on the tax status of banking services. The agreement

---

<sup>4</sup> Value-Added Tax Committee (VATCOM), appointed to consider the comments and representations made by interested parties following the publication of the draft Value-Added Tax Bill published on 18 June 1990 that would give effect to the proposal to introduce an invoice/credit value-added tax system.

<sup>5</sup> *Value-Added Tax Act 89 of 1991 (SA)*.

<sup>6</sup> *Value-Added Tax Act No. 89 of 1991*, s. 2(1).

<sup>7</sup> Listed in *Value-Added Tax Act No. 89 of 1991*, s. 2.

<sup>8</sup> In terms of the addition of a proviso to *Value-Added Tax Act No. 89 of 1991*, s. 2(1), by the *Taxation Laws Amendment Act 37 of 1996*, effective as from 1 October 1996.



reached by the parties in 1996 is documented,<sup>9</sup> and has been updated as of 1 March 2006.<sup>10</sup> The classification of various banking services rendered is provided in the form of a schedule which lists most of the services as taxable, zero-rated, or exempt from VAT.<sup>11</sup> This approach added some degree of certainty for both SARS and the banking industry.

Notwithstanding this agreement, the commercial banks and SARS continued to have disputes over the appropriate allocation of input tax between taxable and exempt supplies. In 2003, SARS, in an effort to reduce the attendant problems, developed a standardized method of apportioning tax on business inputs between taxable and exempt banking services.

With the inclusion of fee-based financial services in the VAT base, there was a concern that transactions would be restructured or manipulated to fall either within or outside the VAT net depending on the requirements of the financial institution or the recipient.

Owing to the narrow margins on interest and the fierce competition amongst banks, a taxation Commission of Inquiry at the time concluded<sup>12</sup> that normal market forces would prevent the risk of excessive restructuring or manipulation. Reclassification of services as interest to the benefit of individuals would be detrimental to the bank which would then be entitled to claim less input tax, a factor which also prevents manipulation.

---

<sup>9</sup> Entitled 'Value-Added Tax: Banking Services Provided and Fees Which May be Charged in Connection With Such Services', drawn up by the Council of South African Bankers and approved by the Commissioner for Inland Revenue (now SARS); issued on 15 August 1996 and effective as from 1 October 1996.

<sup>10</sup> Entitled 'Banking Services Provided and Fees which may be Charged in Connection With Such Services', prepared by the Indirect Tax Standing Committee of the Banking Association South Africa, and approved by SARS, revised and agreed on 2 March 2006 and effective as from 1 March 2006. Any such document issued in the future will have the status of a binding class ruling in terms of *Value-Added Tax Act No. 89 of 1991*, s. 41B, which will have the same binding effect as a binding class ruling issued under s. 78 of the *Tax Administration Act 28 of 2011*.

<sup>11</sup> This document classified services in eight different categories: general banking services, card services, treasury services, credit and lending services, motor and other asset finance, securities services, other services, and international services.

<sup>12</sup> Third Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa (1995), paras. 8.5.29 to 8.5.32.



The South African Competition Commission (anti-trust committee) concluded in 2008 that transactional and interbank charges (bank charges) in South Africa are higher than their international counter-parts. The market structure, because of current information asymmetries and product complexities, means that the banks have the ability to abuse their market power and conspire to charge, by international standards, high explicit fees for many banking services, especially for branded credit cards and services obtained from ATM machines.<sup>13</sup>

There is no empirical evidence available to determine whether financial institutions conceal VAT charges for services rendered to borrowers in higher interest rates charged on consumer loans, and services rendered to depositors in lower interest rates paid on deposits in order to avoid charging VAT on the value of those services. There also appears to be no evidence that the banks have altered the pricing structure for banking services to benefit from the methodology adopted.

## **Object of this research**

### **Research Statement**

This report seeks to identify financial services that are utilised by financial institutions in the South African economy and test them against the provisions of the VAT Act. Financial services provided by the insurance industry are not included in the scope of this report (these are however briefly discussed as they appear in the definition of financial services).

### **Sub-problems**

---

<sup>13</sup> The Competition Commission of South Africa (also known as the anti-trust committee) in its annual report in 2008. See also the Press Statement dated 25 June 2008.



A number of sub-problems will assist in attempting to address the main research problem as detailed above.

Why are financial services exempt from VAT?

What are the characteristics of a 'fee'?

What is that effect of VAT on certain common and complex financial arrangements?

What approach should be used when dealing with a transaction that contains multiple interconnected services?

## **Significance of this research**

This research provides a number of significant contributions. Firstly the report summarizes the current status of VAT on financial services and the history thereto. It then deals with the legal framework of the VAT system and in doing so examines the interpretation of the word 'fee'. Important submissions are made about the interpretation of the word 'fee' as the report (by way of examples) illustrates the complexities in differentiating fees from instruments (especially when dealing complex financial arrangements).

The report discusses the VAT consequences of common financial services and proposes how such services should be treated from a VAT perspective. The services as envisaged in section 2 of the VAT Act are dealt with in detail but at first limited to such services supplied in isolation. The discussion considers the application of VAT in transactions that contain multiple supplies and how the current legislation should be applied to such transactions.

Finally the report examines the VAT consequences on select complex financial arrangements where the line between exempt and taxable services is blurred. It provides a theoretical approach when attempting to determine the VAT consequences on such complex financial arrangements.



## Chapter outline

**Chapter 1** puts forward the current legal framework in which financial services are evaluated with respect to VAT. It highlights the basic operations of the VAT Act with regard to financial services and looks to the reasons provided by VATCOM for the exemption of financial services (noting that while in theory VAT could be applied to financial services, they were exempt due to practical limitations). The idea of taxable fee based financial services versus non fee based exempt financial services is introduced and sets the backdrop on which the following chapters will build.

**Chapter 2** proposes an interpretation of the word ‘fee’ and submits that this is crucial in determining if a financial service is subject to VAT. The word ‘fee’ is not defined by the VAT Act and the discussion seeks to attach meaning to the word by following the South African statutory interpretation approach.

**Chapter 3** examines commonly encountered financial services and the VAT consequences thereof. This chapter for, the most part, is limited to discussing the VAT consequences in isolation and does not assume a multi-part transaction with more than one service supplied.

**Chapter 4** introduces the concept of input tax within the realm of financial services. It examines the requirements of vendors with regard to calculating their input tax entitlement. Input tax relating specifically to financial service providers is also dealt with.

**Chapter 5** deals with a recent court decision regarding VAT within a ‘web of transactions’. Financial institutions often bundle multiple services into one transaction. Often such services are a mix of taxable and exempt supplies. The chapter highlights the court’s approach to the application of VAT with respect to a ‘web of transactions’.

**Chapter 6** tests some of the less common financial arrangements against the provisions of the VAT Act and relevant law. These arrangements are uncommon and often only



occur between financial service providers and selected clients or between banks. The chapter selects limited (and simplified) examples to illustrate the types of transactions and their basic operation. The chapter also proposes the treatment of the VAT consequences of the transactions.

**Chapter 7** deals with ‘twenty-first century’ financial instruments but limits its scope to Crowd Funding, Peer-to-Peer lending and Cryptocurrency. The recent introduction of these offerings to the financial service industry has forced the discussion of these instruments in this report to be largely academic.



# Chapter 1 - The Exempting of Financial Services

It is generally accepted that in theory financial services should be subjected to VAT, bearing in mind that despite being present in the definition of financial services, some transactions, it is submitted, cannot be subject to VAT. One such example is the exchange of money or domestic currency for foreign currency. The exchange of money has no value added and should therefore be exempt. Were there to be no exemption, then the transfer of currency could fall out of the scope of the VAT Act all together<sup>14</sup>.

Financial services are exempt largely due to the South African VAT system being based on the New Zealand GST system. A report issued by KPMG on the potential implementation of VAT on financial services, by the Chinese Government, in China found that there are two main reasons why financial services are exempt:

'The difficulty in measuring the 'value added' to financial services on a transaction-by-transaction basis. For example, when an individual deposits an amount of RMB 10,000 into a bank and is paid 2 percent per annum interest rate, the bank does not subsequently lend that same fixed sum amount to a borrower at say 5 percent per annum of interest, for precisely the same period of time. In practice, the 3 percent 'value added' by the bank in return for its services to each of the borrower and the deposit holder cannot be measured on a transaction-by-transaction basis.

Financial services facilitate the buying and selling of goods and services. The granting of an exemption from VAT recognises that lending and deposit-taking are merely the means by which businesses and individuals fund consumption activities – that is, lending to facilitate the early purchase of goods or services upon which VAT is then levied, and deposit-taking to facilitate the deferred purchase of goods and services upon which VAT is then levied.<sup>15</sup>

---

<sup>14</sup>This assumes that the legal tender of South Africa (Rand) is transferred from one person to another and not some other currency in exchange for a different currency.

<sup>15</sup> Proposals to apply VAT to the financial services sector in China November 2013 ([www.kpmg.com/cn](http://www.kpmg.com/cn))





VATCOM<sup>16</sup> cited the following consequences and practical implications of exempting financial services:

'The consequences and practical difficulties are the following:

- (a) There will not be double taxation which would arise if the services were exempt and rendered to vendors.
- (b) The cost of borrowing by private persons for housing, consumer durables etc. will increase by the full rate of VAT which at present levels of interest, and assuming a 10 per cent VAT rate, could amount to between 2,0 to 2,9 per cent. It could be argued that the price of many other goods and services will also increase by a similar amount and there is no reason for special treatment for financial services.
- (c) The taxation will create a strong incentive for disintermediation, particularly in the case of household borrowers. Buyers will bypass financial institutions and go directly to the private investor for funds. Financial institutions will be encouraged to act as agents bringing non-vendor investors and private borrowers together.
- (d) Financial institutions provide an enormous range of services and instruments which can be changed with relative ease if more favourable tax treatment can be obtained. In addition, there are millions of investors and depositors in financial institutions. If tax is imposed the institutions will have to establish in each case whether the investor is a vendor or not. In the case of vendors, financial institutions will be required to pay VAT in addition to the rate of interest. Tax invoices will also have to be obtained from the vendors so that the institutions can claim input tax. If invoices are not required, there would be an incentive for investors who are not vendors to have themselves falsely classified as vendors by the institution as they would receive a better return (i.e. plus VAT). It would not be possible to use a monetary value to classify investors as vendors, as vendors carrying on activities other than investment also invest money. A decision will have to be made on each account to decide whether it is the investor's business or private account.

In discussions held with financial institutions they were very strongly of the opinion that their systems could not handle the volume of transactions as well as the very large increase in paperwork. They claimed that their position could not be compared with any other vendor, because if the vast number of their "suppliers".

---

<sup>16</sup> Report of the Value-Added Tax Committee (VATCOM) issued by the Government of the Republic of South Africa



- (e) The taxation of interest will also increase the number of vendors who will have to register. Investors, often people who are not in business, for example, widows, pensioners, etc. will be required to submit returns.
- (f) The tax will also have to be imposed on existing loans as banks would otherwise suffer losses. The transition will require careful consideration as it will affect existing agreements.

The organisations who favour the exemption acknowledge that it does favour private consumers to the extent that VAT is not imposed on the value added by financial institutions. They point out, however, that this loss of revenue is largely compensated for by the double taxation that occurs when financial services are rendered to vendors. It is claimed that by far the largest portion of interest is paid by vendors.

The compliance costs of a full invoice VAT for financial institutions and a number of investors who will have to register is likely to be higher than the compliance costs of exemption.

It is also argued that no country has as yet been able to overcome the difficulties foreseen with taxation of financial services and it is not advisable that South Africa do pioneering work in this regard.'

It is clear from the above extracts that VAT could be levied on financial services. It is equally as clear, that doing so would result in a prohibitive administration burden on the financial institutions providing the services envisaged. Ultimately the VAT Act, when signed into power, exempted financial services and these sections have remained largely unchanged since implementation.

The financial services as set out in the VAT Act are dealt with in two sections. The definition of financial services contained in section 1 of the VAT Act. This definition simply refers the reader to section 2 of the VAT Act titled 'financial services'. This section is as follows:



**‘2. Financial services.** (1) For the purposes of this Act, the following activities shall be deemed to be financial services:

- (a) The exchange of currency (whether effected by the exchange of bank notes or coin, by crediting or debiting accounts, or otherwise);
- (b) the issue, payment, collection or transfer of ownership of a cheque or letter of credit;
- (c) the issue, allotment, drawing, acceptance, endorsement or transfer of ownership of a debt security;
- (d) the issue, allotment or transfer of ownership of an equity security or a participatory security;
- (e) . . . . .
- ( f ) the provision by any person of credit under an agreement by which money or money’s worth is provided by that person to another person who agrees to pay in the future a sum or sums exceeding in the aggregate the amount of such money or money’s worth;
- (g) . . . . .
- (h) . . . . .
- (i) the provision, or transfer of ownership, of a long-term insurance policy or the provision of reinsurance in respect of any such policy: Provided that such an activity shall not be deemed to be a financial service to the extent that it includes the management of a superannuation scheme;
- ( j ) the provision, or transfer of ownership, of an interest in a superannuation scheme;
- (k) the buying or selling of any derivative or the granting of an option: Provided that where a supply of the underlying goods or services takes place, that supply shall be deemed to be a separate supply of goods or services at the open market value thereof: Provided further that the open market value of those goods or services shall not be deemed to be consideration for a financial service as contemplated in this paragraph:
- (l) . . . . .
- (m) . . . . .
- (n) . . . . .

Provided that the activities contemplated in paragraphs (a), (b), (c), (d) and ( f ) shall not be deemed to be financial services to the extent that the consideration payable in respect thereof is any fee, commission, merchant’s discount or similar charge, excluding any discounting cost.

(2) For the purposes of subsection (1)—

- (i) **“cheque”** means a bill drawn on a bank payable on demand, a postal order, a money order, a traveller’s cheque, or any order or authorisation (whether in writing, by electronic means, or otherwise) to a financial institution to credit or debit any account;



(ii) **“currency”** means any banknote or other currency of any country, other than when used as a collector’s piece, investment article, item of numismatic interest, or otherwise than as a medium of exchange;

(iii) **“debt security”** means—

(aa)

an interest in or right to be paid money; or

(bb)

an obligation or liability to pay money

that is, or is to be, owing by any person, but does not include a cheque;

(iiiA) **“derivative”** means a derivative as defined in International Accounting Standard 39 of the International Accounting Standards issued by the International Accounting Standards Board;

(iv) **“equity security”** means any interest in or right to a share in the capital of a juristic person or the interest in a close corporation of a member thereof;

(v) **“long-term insurance policy”** means any policy of insurance issued in the ordinary course of carrying on long-term insurance business as defined in [section 1 \(1\)](#) of the Long-term Insurance Act, 1998 ([Act No. 52 of 1998](#));

(vA) **“merchant’s discount”** means a charge made to merchants for accepting a credit or debit card as payment for the supply of goods or services, or a similar charge made by a buying organisation;

(vi) **“participatory security”** means a participatory interest as defined in section 1 of the Collective Investment Schemes Control Act, 2002 (Act No. 45 of 2002), but does not include an equity security, a debt security, money or a cheque;

(vii) **“superannuation scheme”** means a scheme whereby provision is made for the payment or granting of benefits by a benefit fund, pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund as defined in [section 1](#) of the Income Tax Act.

(3) Notwithstanding subsection (2), the terms “debt security”, “equity security” and “participatory security” do not include any of the following:

(a) A long-term insurance policy or any other policy of insurance;

(b) any ownership or interest in land, other than an interest as mortgagee;

(c) a share in the share capital of a share block company;

(d) any interest of a member of a close corporation which confers on the member a time-sharing interest as defined in section 1 of the Property Time-sharing Control Act, 1983 (Act No. 75 of 1983), on the terms and conditions contained in the association agreement of such close corporation;

(e) an interest in a superannuation scheme.

(4) Notwithstanding anything in this section, the term “financial services” does not include—



- (a) the cession, assignment, transfer or other supply of any right to receive payment in relation to any taxable supply where, as a result of any such cession, assignment, transfer or supply, output tax in relation to that taxable supply would not be or become attributable to any tax period for the purposes of section 16 (3); or
- (b) . . . . .
- (c) the transfer of any interest in or right to be paid money that is, or is to be, owing by a share block company under its loan obligation, as defined in section 1 of the Share Blocks Control Act, to any person who is or will be a shareholder of such share block company.<sup>17</sup>

South Africa does however have one major proviso that differentiates its tax system from most of the others. The proviso to the definition of financial services in section 2(1)<sup>18</sup> (as shown in the above extract) excludes certain fees charged in relation to the activities which are deemed to be financial services. The consequence of this is that certain fee based financial services will be a taxable supply.

The following analysis will elaborate on each part of the definition above.

## The Legal Framework

The VAT Act by implication excludes from the exemption, explicit fees charged for the provision of certain financial services. The VAT Act achieves this by defining ‘financial services’ in a manner that excludes explicit fee-based services rendered (international financial services are treated as a zero rated export and will be discussed under the sub heading Reverse Charges in Chapter 3- Common Financial Services).

The term ‘financial services’ as so defined is descriptive rather than principle-based. The statutory definition of the term ‘financial services’ is also exclusive and exhaustive,<sup>19</sup> and

---

<sup>17</sup> Section 2 of Value-Added Tax Act No. 89 of 1991

<sup>18</sup> of Value-Added Tax Act No. 89 of 1991

<sup>19</sup> See *Jones & Co Ltd v CIR* 1926 CPD 1, 2 SATC 7 at 10. Followed and applied in *Guernsey & Foreign Investment Trust Ltd v CIR* 1938 CPD 158, 9 SATC 390.



means the specifically defined activities which are deemed by section 2 of the VAT Act to be financial services.<sup>20</sup>

A notable feature of the definition of 'financial services' is its focus on transactions as opposed to the entity supplying the service. The activities included in the definition of 'financial services' are exempt irrespective of whether or not they are carried out by an entity, the main business of which is the provision of financial services. The result of this is that financial services, even as a byproduct of an entity's revenue, are still exempt on a transaction by transaction basis. This impacts upon the claiming of input VAT which will be discussed in Chapter 4 - Input Tax.

The following activities listed in section 2<sup>21</sup> are deemed to be financial services:

The exchange of currency (section 2(1)(a))<sup>22</sup>:

'(a) The exchange of currency (whether effected by the exchange of bank notes or coin, by crediting or debiting accounts, or otherwise);'

It matters not whether the process of exchange from one currency into another is in the form of bank notes, coins or by way of crediting and debiting accounts or otherwise. Only the activity of exchanging currency for a margin is considered to be a financial service. Where a business converts sales consideration received in foreign currency into local currency, such exchange into local currency is not considered to be a financial service supplied by the business.

The function of the definition of the term 'currency' in section 1<sup>23</sup> is to cover monies used as a medium of exchange. It is defined as any banknote or other currency of any country, other than when used as a collector's piece, investment article, item of numismatic

---

<sup>20</sup> *Value-Added Tax Act No. 89 of 1991*, s. 1(1), definition of 'financial services'.

<sup>21</sup> of *Value-Added Tax Act No. 89 of 1991*

<sup>22</sup> of the *Value-Added Tax Act No. 89 of 1991*

<sup>23</sup> of the *Value-Added Tax Act No. 89 of 1991*



interest or otherwise than as a medium of exchange (section 2(2)(ii)<sup>24</sup>). Any exchange of one recognized legal tender for another would therefore fall within the ambit of this provision, whether it be effected by bank notes or coins, by the crediting or debiting of accounts or in any other manner.

While the exchange of currency constitutes an exempt financial service, should any fee, commission or similar charge (but not any discounting cost) be levied for that service, such fee, commission or charge will be subject to tax by virtue of the proviso to section 2(1)<sup>25</sup>.

A bank providing foreign exchange facilities is engaging in exempt transactions for VAT purposes, provided no separate fee, commission or similar charge is levied for providing such exchange facilities. Where, however, no specific charge is made for exchanging currency (but the bank merely quotes a difference between the buying and selling rates), there is an argument that the difference which accrues to the agent or bank is not a 'fee, commission or similar charge' as contemplated in the proviso to section 2(1)<sup>26</sup>.

It is stated in the Explanatory Memorandum on the Taxation Laws Amendment Bill, 1996 that the difference in buying and selling rates 'is consideration for the exchange of currency and, therefore, exempt from VAT'.<sup>27</sup> However, if a travel agent (which does not itself have the facility to provide the foreign exchange) charges a fee for arranging that a bank exchanges the currencies, this is not a financial service and is therefore subject to VAT.

If, however, a collector acquires Krugerrands and pays in foreign or local currency, the transaction is taxable, not exempt, since for the purposes of section 2(1)(a)<sup>28</sup>, the

---

<sup>24</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>25</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>26</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>27</sup> [WP 3—'96] Republic of South Africa, Explanatory Memorandum on the Taxation Laws Amendment Bill, 1996 at 10.

<sup>28</sup> of the Value-Added Tax Act No. 89 of 1991



Krugerrands so acquired would not qualify as ‘currency’, and consequently no exchange of currency has occurred. But if the collector’s piece, investment article or item of numismatic interest consists of a gold coin issued by the Reserve Bank (including Krugerrands), the supply will be zero-rated (section 11(1)(k))<sup>29</sup>.

The issue, payment, collection or transfer of ownership of a cheque or letter of credit (section 2(1)(b))<sup>30</sup>:

‘(b) the issue, payment, collection or transfer of ownership of a cheque or letter of credit;’<sup>31</sup>

The issue, allotment, drawing, acceptance, endorsement, transfer of ownership of a debt security (section 2(1)(c))<sup>32</sup>:

‘(c) the issue, allotment, drawing, acceptance, endorsement or transfer of ownership of a debt security’<sup>33</sup>

A ‘debt security’ is widely defined in section 2(2)(iii)<sup>34</sup> as an interest in or right to be paid money that is or is to be owing by any person or an obligation or liability to pay money, but does not include a ‘cheque’ as defined. The term embraces trade debts, loan accounts, promissory notes, interest swaps and a wide variety of other rights to be paid money or obligations to pay money.

The issue, allotment or transfer of ownership of an equity security or a participatory security (section 2(1)(d))<sup>35</sup>:

‘(d) the issue, allotment or transfer of ownership of an equity security or a participatory security’<sup>36</sup>

---

<sup>29</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>30</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>31</sup> Value-Added Tax Act No. 89 of 1991, s. 2(1)(b)

<sup>32</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>33</sup> Value-Added Tax Act No. 89 of 1991, s. 2(1)(c)

<sup>34</sup> Value-Added Tax Act No. 89 of 1991

<sup>35</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>36</sup> Value-Added Tax Act No. 89 of 1991, s. 2(1)(d)





Such a transaction may be subject to securities transfer tax.<sup>37</sup> The term 'equity security' is defined as any interest in or right to a share in the capital of a juristic person or a member's interest in a close corporation (section 2(2)(iv))<sup>38</sup>, for example, shares in a company. An 'equity security' does not include a long-term insurance policy, the ownership of or an interest in land, a share in the share capital of a share block company, any time-sharing interest conferred by a member's interest in a close corporation or an interest in a superannuation scheme.

The term 'participatory security' is defined as encompassing a 'participatory interest' as defined in section 1 of the *Collective Investment Schemes Control Act*<sup>39</sup> but does not include an equity security, a debt security, money or a cheque (section 2(2)(vi))<sup>40</sup>. Participatory securities also do not include any long-term insurance policy, any ownership or interest in land, a share in the share capital of a share block company, any time-sharing interest or an interest in a superannuation scheme (section 2(3))<sup>41</sup>.

The provision by any person of credit under an agreement by which money or money's worth is provided by that person to another person who agrees to pay in the future a sum or sums exceeding in the aggregate the amount of such money or money's worth (section 2(1)(f))<sup>42</sup>:

'( f ) the provision by any person of credit under an agreement by which money or money's worth is provided by that person to another person who agrees to pay in the future a sum or sums exceeding in the aggregate the amount of such money or money's worth;'<sup>43</sup>

---

<sup>37</sup> The Securities Transfer Tax Act, 2007 calls for securities transfer tax to be levied on the transfer of securities. The Securities Transfer Tax Administration Act, 2007 contains the administration provisions governing the payment of securities transfer tax.

<sup>38</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>39</sup> Act 45 of 2002.

<sup>40</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>41</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>42</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>43</sup> Value-Added Tax Act No. 89 of 1991, s. 2(1)(f)



‘Credit’ for this purpose refers to a contractual arrangement whereby a borrower receives a loan or something of monetary value and agrees to deferred repayment, which requires that interest or other monetary return becomes due and payable. An interest-free loan will therefore not qualify as an exempt supply which means that it would not be considered in the calculation of the ratio of taxable to exempt supplies for any particular organization.

The provision or transfer of ownership of a long-term insurance policy or the provision of reinsurance for any such policy (section 2(1)(i)<sup>44</sup>):

‘(i) the provision, or transfer of ownership, of a long-term insurance policy or the provision of reinsurance in respect of any such policy: Provided that such an activity shall not be deemed to be a financial service to the extent that it includes the management of a superannuation scheme;’<sup>45</sup>

The term ‘long-term insurance policy’ is defined (section 2(2)(v)<sup>46</sup>) as ‘any policy of insurance issued in the ordinary course of carrying on long-term insurance business as defined in section 1 of the *Long-term Insurance Act, 1998*’.<sup>47</sup> A ‘long-term insurance policy’ would include a funeral policy, a home service policy, an industrial policy and a sinking policy (as defined in section 1 of the *Long-term Insurance Act*).

The provision, or transfer of ownership, of an interest in a superannuation scheme (section 2(1)(j)<sup>48</sup>):

‘(j) the provision, or transfer of ownership, of an interest in a superannuation scheme;’<sup>49</sup>

---

<sup>44</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>45</sup> Value-Added Tax Act No. 89 of 1991, s. 2(1)(h)

<sup>46</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>47</sup> Act 52 of 1998.

<sup>48</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>49</sup> Value-Added Tax Act No. 89 of 1991, s. 2(1)(j)



A 'superannuation scheme' is a scheme under which provision is made for the payment or granting of benefits by a 'benefit fund', 'pension fund', 'pension preservation fund', 'provident fund', 'provident preservation fund' or 'retirement annuity fund' as defined in section 1 of the Income Tax Act 58 of 1962. Since registered medical-aid schemes are included in the definition of the term 'benefit fund' in section 1 of the Income Tax Act 58 of 1962, contributions to such schemes are exempt for VAT purposes, being payment for a financial service.

The buying or selling of any derivative or the granting of an option is deemed to be an exempt financial service (section 2(1)(k)<sup>50</sup>):

'(k) the buying or selling of any derivative or the granting of an option: Provided that where a supply of the underlying goods or services takes place, that supply shall be deemed to be a separate supply of goods or services at the open market value thereof: Provided further that the open market value of those goods or services shall not be deemed to be consideration for a financial service as contemplated in this paragraph.'<sup>51</sup>

The subsequent supply of the underlying goods or services is deemed to be a separate supply and not a financial service.

The deemed financial services listed above specifically exclude the activities in sections 2(1)(a), (b), (c), (d) and (f)<sup>52</sup> to the extent that the consideration payable for these activities is any fee, commission, merchant's discount or similar share, but not a discounting cost. Consequently, if any of these activities are rendered for the payment of an explicit fee, they are deemed not to be financial services to the extent of the explicit fee charged.

---

<sup>50</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>51</sup> Value-Added Tax Act No. 89 of 1991, s. 2(1)(h)

<sup>52</sup> of the Value-Added Tax Act No. 89 of 1991



The scope of exempt financial services was further limited by the inclusion of a merchant's discount as a fee-based activity.<sup>53</sup> A 'merchant's discount' is defined in section 2(2)(vA)<sup>54</sup> as a charge made to merchants for accepting a credit or debit card as payment for the supply of goods or services, or a similar charge by a buying organization. Any service fee or charge similar to that of a merchant's discount also excludes the underlying activity to such extent from a financial service. Although a merchant's discount is excluded as a 'financial service', the High Court has ruled that discounts received by a buy-aid organization from suppliers of goods or services as a result of prompt payment, do not fall within the definition of 'services' in the Vat ACT, and as such are not subject to VAT.<sup>55</sup> A discounting cost, namely, where a debt security such as a book debt is transferred at a discount to its face value, does not exclude the transfer of the debt security from a 'financial service'. The discounting cost itself is also not subject to VAT by virtue of its specific exclusion from the proviso to section 2(1) of the VAT Act.

Where the activities deemed to be financial services comprise a 'supply',<sup>56</sup> such supply is exempt from VAT in terms of section 12(a)<sup>57</sup>. If the supply of the financial services would, but for the provisions of section 12(a)<sup>58</sup> qualify for VAT at the zero rate in terms of section 1<sup>59</sup>, then the exemption provisions of section 12(a)<sup>60</sup> do not apply and the zero-rating takes preference. Consequently, the supply of financial services to non-residents who are not present in South Africa when the services are rendered, are subject to VAT at the zero rate and are not exempt.

---

<sup>53</sup> In the proviso to *Value-Added Tax Act No. 89 of 1991*, s. 2(1), introduced by virtue of *Taxation Laws Amendment Act 30 of 1998*, s. 87(1)(a), effective as from 1 March 1999.

<sup>54</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>55</sup> *Commissioner for South African Revenue Service v Cape Consumers (Pty) Ltd* (61 SATC 91), 23 March 1999.

<sup>56</sup> *Value-Added Tax Act No. 89 of 1991*, s. 1(1), defines a 'supply' to include performance in terms of a sale, rental agreement, instalment credit agreement and all other forms of supply, whether voluntary, compulsorily or by operation of law, irrespective of where the supply is effected, and any derivative of 'supply' shall be construed accordingly.

<sup>57</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>58</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>59</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>60</sup> of the Value-Added Tax Act No. 89 of 1991



The Tax Court<sup>61</sup> has, however, ruled that the provisions of sections 12(a) and 11<sup>62</sup> will apply only if the financial services are supplied in the course or furtherance of an enterprise making taxable supplies. Therefore, where shares are held as an investment, the mere holding of shares is not an enterprise and therefore the disposal of these shares does not fall within the ambit of section 7(1)(a)<sup>63</sup>. Such a supply to a South African resident is thus not considered to be an exempt supply in terms of section 12(a)<sup>64</sup> or zero rated in terms of the provisions of section 11(2)(a)<sup>65</sup> in the case of a non-resident. Such a supply, being neither exempt nor zero rated, falls outside the scope of VAT.

On 17 July 2013 the Minister of Finance initiated a tax review to assess the South African tax policy framework and its role in supporting the objectives of inclusive growth, employment, development and fiscal sustainability. The Tax Review Committee<sup>66</sup> established for this purpose, was specifically tasked to consider the VAT treatment of financial services and VAT apportionment within the financial sector, to review the efficiency and equity of the VAT system and specifically the advisability and effectiveness of dual rates, zero rating and exemptions.<sup>67</sup> On 7 July 2015 the Tax Review Committee published its first interim report on VAT for public comment.<sup>68</sup> It identified VAT cascading in the financial services sector as the most important area for consideration, and recommended that the various approaches adopted in other jurisdictions to mitigate VAT cascading should receive further urgent consideration.

---

<sup>61</sup> Case No. VAT 382, Tax Court Cape Town 13 June 2011, para. 63.

<sup>62</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>63</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>64</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>65</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>66</sup> Known as the Davis Tax Committee.

<sup>67</sup> South African Treasury, *2013 Budget Review*, p. 63.

<sup>68</sup> Tax Review Committee, Media Statement: Release of Davis Tax Committee First Interim Report on VAT for Public Comment, 7 July 2015. Available at: <http://www.taxcom.org.za/docs/20150707%20DTC%20VAT%20First%20Interim%20Report%20for%20public%20comment.pdf>.



## Chapter 2 – The meaning of the word ‘Fee’

The proviso to subsection 1 of section 2 of the VAT Act excludes fees and other like consideration from being a financial service. The proviso reads as follows:

‘Provided that the activities contemplated in paragraphs (a), (b), (c), (d) and ( f ) shall not be deemed to be financial services to the extent that the consideration payable in respect thereof is any fee, commission, merchant’s discount or similar charge, excluding any discounting cost.’

It is submitted that the primary differentiator between taxable financial services and exempt financial services is whether the consideration for the supply is a fee or compensation similar to a fee.

‘Fee’ is not defined by the VAT Act. In order to determine what is meant by the legislator by the use of the word ‘fee’ one must apply the principles of statutory interpretation. A brief discussion of these principles and an extract from Wallis JA’s his judgement of *Natal Joint Municipal Pension Fund v Endumeni Municipality* is contained in ‘Annexure A’ of this report.

In accordance with the principles of statutory interpretation, one can look to other authorities if the meaning of a word or phrase is unclear. Authorities such as repealed acts, dictionaries or works of literature written by learned authors on the subject can be used as an aid in determining the meaning of the word ‘fee’.



The schedule to the now repealed Usury Act<sup>69</sup> contained definitions of certain types of fees. These definitions will serve as an interpretive aid to the meaning of the word fee in the VAT Act.

The definitions as they appeared in the Usury Act<sup>70</sup> are as follows:

‘ "administration fee"

means an amount payable by the borrower to the moneylender--

- a) where such amount is in terms of an agreement in writing between the moneylender and the borrower recoverable from the borrower;
- b) as valuable consideration for the moneylender's administering the borrower's account; and
- c) where the total amount payable per month does not exceed the amount mentioned in paragraph 3(b)(i);

"initiation fee"

means a single fee not greater than the amount mentioned in paragraph 3(b)(ii) payable by the borrower to the moneylender --

- a) in terms of an agreement in writing between the moneylender and the borrower;
- b) as valuable consideration for services rendered in connection with the registration of the mortgage bond in question; and
- c) at the conclusion of the money lending transaction in question; ’

The definitions highlight a number of factors that need to be present in order for a transaction to be classed as a fee, the first of which would require the payment of money from one party to another in accordance with an agreement between the two parties. This in isolation would be a donation and thus the money must be transferred in return for ‘something’. That ‘something’ must be identifiable as a service rendered to the payer.

The Webster’s College Dictionary<sup>71</sup> defines ‘fee’ as :

---

<sup>69</sup> Usury Act No. 73 of 1968

<sup>70</sup> Usury Act No. 73 of 1968

<sup>71</sup> Webster’s College Dictionary



‘a sum charged or paid, as for professional services or a privilege’

This definition, although not as descriptive as the one contained in the schedules of the repealed Usury Act<sup>72</sup>, carries the same criteria *id-est* money (a sum) is transferred (charged or paid) in return for a service.

The guidance to International Accounting Standard (‘IAS’) 18 contains descriptive examples of financial service fees. Accounting standards should be considered with extreme caution as it has been established by the courts that the accounting treatment of a transaction has no effect on the legal or economical substance of the transaction<sup>73</sup>. It is submitted that one should view the below extracts only as a guide to possible types of fees charged for financial services rendered or ones normally contained in financial contracts.

‘Financial service fees. The recognition of revenue for financial service fees depends on the purposes for which the fees are assessed and the basis of accounting for any associated financial instrument. The description of fees for financial services may not be indicative of the nature and substance of the services provided. Therefore, it is necessary to distinguish between fees that are an integral part of the effective interest rate of a financial instrument, fees that are earned as services are provided, and fees that are earned on the execution of a significant act.’<sup>74</sup>

This extract from the descriptive examples of IAS 18 highlights some common types of financial instruments which are likely to contain both fees and interest.

‘(a) Fees that are an integral part of the effective interest rate of a financial instrument.

Such fees are generally treated as an adjustment to the effective interest rate. However, when the financial instrument is measured at fair value with the change in fair value

---

<sup>72</sup> Usury Act No. 73 of 1968

<sup>73</sup> See CIR v George Forest Timber Co Ltd 1924 AD 516 at 522 and 528; Pyott Ltd v CIR 1945 AD 128 at 135 and 136

<sup>74</sup> International Accounting Standard 18 Revenue Illustrative Examples paragraph 14





recognised in profit or loss, the fees are recognised as revenue when the instrument is initially recognised.

(i) Origination fees received by the entity relating to the creation or acquisition of a financial asset other than one that under IFRS 9 is measured at fair value through profit or loss.

Such fees may include compensation for activities such as evaluating the borrower's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument and, together with the related transaction costs \* (as defined in IAS 39), are deferred and recognised as an adjustment to the effective interest rate.

(ii) Commitment fees received by the entity to originate a loan when the loan commitment is outside the scope of IFRS 9.

If it is probable that the entity will enter into a specific lending arrangement and the loan commitment is not within the scope of IFRS 9, the commitment fee received is regarded as compensation for an ongoing involvement with the acquisition of a financial instrument and, together with the related transaction costs (as defined in IAS 39), is deferred and recognised as an adjustment to the effective interest rate. If the commitment expires without the entity making the loan, the fee is recognised as revenue on expiry. Loan commitments that are within the scope of IFRS 9 are accounted for as derivatives and measured at fair value.

(iii) Origination fees received on issuing financial liabilities measured at amortised cost.

These fees are an integral part of generating an involvement with a financial liability. When a financial liability is not classified as at fair value through profit or loss, the origination fees received are included, with the related transaction costs (as defined in IAS 39) incurred, in the initial carrying amount of the financial liability and recognised as an adjustment to the effective interest rate. An entity distinguishes fees and costs that are an integral part of the effective interest rate for the financial liability from origination fees and transaction costs relating to the right to provide services, such as investment management services.

(b) Fees earned as services are provided.

(i) Fees charged for servicing a loan.

Fees charged by an entity for servicing a loan are recognised as revenue as the services are provided.



(ii) Commitment fees to originate a loan when the loan commitment is outside the scope of IFRS 9.

If it is unlikely that a specific lending arrangement will be entered into and the loan commitment is outside the scope of IFRS 9, the commitment fee is recognised as revenue on a time proportion basis over the commitment period. Loan commitments that are within the scope of IFRS 9 are accounted for as derivatives and measured at fair value.

(iii) Investment management fees.

Fees charged for managing investments are recognised as revenue as the services are provided. Incremental costs that are directly attributable to securing an investment management contract are recognised as an asset if they can be identified separately and measured reliably and if it is probable that they will be recovered. As in IAS 39, an incremental cost is one that would not have been incurred if the entity had not secured the investment management contract. The asset represents the entity's contractual right to benefit from providing investment management services, and is amortised as the entity recognises the related revenue. If the entity has a portfolio of investment management contracts, it may assess their recoverability on a portfolio basis.

Some financial services contracts involve both the origination of one or more financial instruments and the provision of investment management services. An example is a long-term monthly saving contract linked to the management of a pool of equity securities. The provider of the contract distinguishes the transaction costs relating to the origination of the financial instrument from the costs of securing the right to provide investment management services.<sup>75</sup>

On consideration of the above examples provided by IFRS (again viewed with extreme caution) one can see that, with clever construction of the terms and conditions of a loan agreement, fees can be made to mimic what would normally be interest. It is therefore of paramount importance to determine how fees differ from interest in the context of financial services.

The National Credit Act<sup>76</sup> requires that fees be included in the calculation for the maximum interest that can be charged on a loan. This is done through the introduction of the concept

---

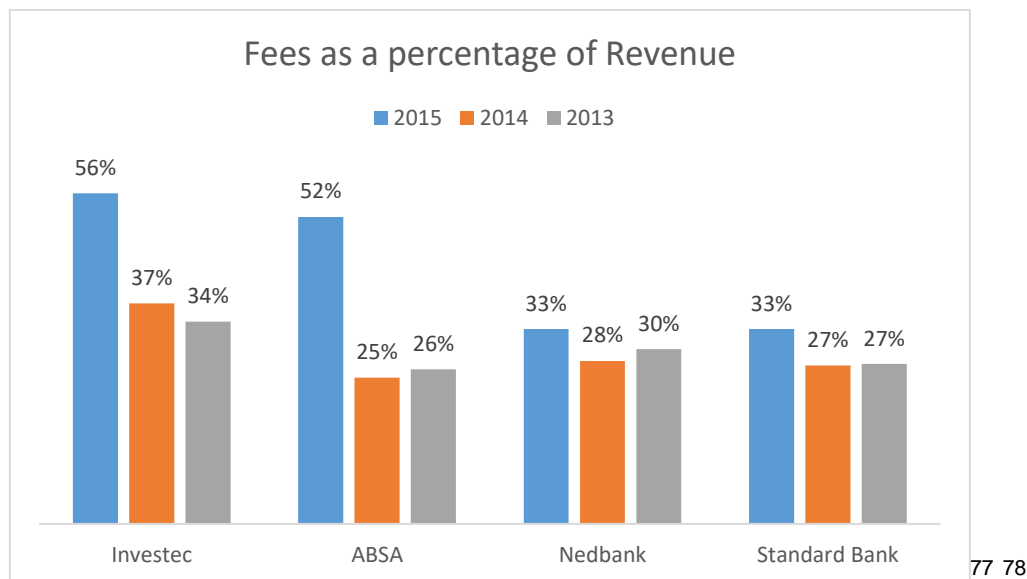
<sup>75</sup> International Accounting Standard 18 Revenue Illustrative Examples paragraph 14

<sup>76</sup> National Credit Act No. 34 of 2005



of a 'deferred amount' and a prescribed formula for the calculation of interest (see 'Annexure B'). This indicates that in some instances the legislator treats a fee in the same way as interest with regard to debt transactions. The provision serves as protection for borrowers against low interest-high fee loans as Lenders sometimes use fees on a loan to improve profitability and effectively increase their return on monies advanced.

Fee income in the banking sector is a large contributor to the respective bank's revenue and profit. The chart below shows the contribution of fees to total revenue of four major banks in South Africa.



There is clearly a shift towards fee based services in the banking sector and the greater financial services sector as a whole. This shift is partly driven by the increasing revenue generated from 'capital light' services as well as a favoring of fees as opposed to margin

<sup>77</sup> Extracted from respective banks annual financial statements for years ended 2013,2014,2015

<sup>78</sup> Investec Bank Limited, ABSA Group Limited, Nedbank Group Ltd, Standard Bank Group Limited

income. Reasons for this include tighter capital controls introduced by Basel III resulting in smaller interest margins and increased regulation regarding 'on balance-sheet financing'.

Capital light services are generally banking services that do not require a bank to hold capital against them. These services include asset management, wealth management and advisory. All these activities do not require the use of depositor's money but are rather the result of the employees of the bank's efforts and intellect.

It is submitted based on the previous discussion that in order for an amount to be treated as a fee, the contract must explicitly provide for the charging of this fee. It is further submitted that the party charging the fee must be providing a service that is identifiable from the underlying financial service and that the fee relates to such additional service as stipulated in the agreement.

The definition of 'financial services' in section 2 of the VAT Act is central to the VAT treatment of fees on financial services. Insofar as is here relevant, the definition deems, for the purposes of the VAT, the activities listed in paragraphs (a) to (k) to be financial services. The second function is to exclude from the definition of 'financial services' certain fee-based activities. The proviso to section 2<sup>79</sup> states that:

'... the activities contemplated in paragraphs (a), (b), (c), (d) and (f) [of section 2] shall not be deemed to be financial services to the extent that the consideration payable in respect thereof is any fee, commission, merchant's discount or similar charge, excluding any discounting cost.'

The provision of credit and the granting of loans are thus excluded from the definition of 'financial services' to the extent that any explicit fee or commission is charged to a

---

<sup>79</sup> of the Value-Added Tax Act No. 89 of 1991



borrower in relation to the provision of the credit.<sup>80</sup> Consequently, it is submitted, any explicit fees charged to a borrower in relation to a loan are subject to VAT. Such fees include, amongst others, documentation fees, facility fees, commitment fees, raising fees, initiation fees, valuation fees and guarantee fees. Certain of these fees such as commitment fees or guarantee fees are in some cases quoted to clients as a percentage of the capital sum and almost mimic interest. This presents an opportunity for both tax planning and avoidance and will be discussed under Chapter 6 - Complex Financial Arrangements.

To the extent that the loans are granted to non-residents, the fees and interest may qualify for the rate of zero per cent in terms of section 11(2)(e)<sup>81</sup>.

---

<sup>80</sup> *Value-Added Tax Act No. 89 of 1991*, proviso to s. 2(1).

<sup>81</sup> of the *Value-Added Tax Act No. 89 of 1991*



# Chapter 3 - Common Financial Services Provided

## Loan Intermediation and Lending Transactions

Loan intermediation is the process of lending money or monies worth in return for interest.

Section 2(1)(f) of the VAT Act contains the following provision:

‘the provision by any person of credit under an agreement by which money or money’s worth is provided by that person to another person who agrees to pay in the future a sum or sums exceeding in the aggregate the amount of such money or money’s worth;’

‘Credit’ for this purpose refers to a contractual arrangement whereby a borrower receives funds or something of monetary value and agrees to repayment at a future date, as well as a charge for the use of the money or money’s value, payable in favour of the lender normally referred to as interest.

The interest or monetary return in excess of the loan amount or monetary value provided constitutes consideration for the financial service supplied, which is exempt from VAT in terms of section 12 of the VAT Act. Any activity, to the extent that it involves the making of an exempt supply, is deemed not to be carrying on of an enterprise.<sup>82</sup> An amount of VAT paid on the acquisition of goods or services only qualifies as input tax to the extent that the goods or services are acquired for the purpose of use, consumption or supply in the course of making taxable supplies. Consequently, the VAT incurred on any goods or services acquired for the purpose of granting credit, which is an exempt supply, does not qualify as input tax.

---

<sup>82</sup> *Value-Added Tax Act No. 89 of 1991*, s. 1(1), proviso (v) to the definition of ‘enterprise’.



The exemption applies, irrespective of the VAT status of the recipient of the credit provided, and therefore applies to so-called 'business-to-business' (B2B) and 'business-to-consumer' (B2C) transactions. This inevitably gives rise to the cascading of VAT, as many of the input costs that a financial service institution faces are taxable supplies. For example banks rely heavily on information technology (I.T.) systems for processing transactions, record keeping, accounting and reporting. The costs of such systems can be hundreds of millions of rand and the provision of the vast majority of these services are taxable supplies. The bank is therefore subjected to the additional 14% cost in the form of a denied or at best, a partial input tax deduction. The non-deductible VAT is then passed on to the recipient either in the form of a higher interest charge or fee.

An exception applies where the credit is provided to a non-resident of South Africa who is not present in South Africa when the financial service is supplied. Such supplies are subject to VAT at the rate of zero percent,<sup>83</sup> being a taxable supply,<sup>84</sup> which allows the supplier to deduct the VAT incurred on related expenses as input tax. This practice is not as common as a result of exchange controls.<sup>85</sup>

All types of loans constitute financial services where the borrower agrees to pay in the future amounts exceeding in the aggregate the loan amount or monetary value advanced. Such loans would include the provision of credit on a bank overdraft or credit card, secured and unsecured loans, mortgage loans, security loans and commodity loans.

The interest or similar charges in respect of the provision of these loans will comprise consideration for the exempt provision of credit, and as such will also be exempt from VAT. This includes manufactured dividends or manufactured interest in relation to

---

<sup>83</sup> *Value-Added Tax Act No. 89 of 1991*, s. 11(2)(i).

<sup>84</sup> A 'taxable supply' is defined in section 1(1) to mean any supply of goods or services which is chargeable with tax under the provisions of *Value-Added Tax Act No. 89 of 1991*, s. 7(1)(a), including tax chargeable at the rate of zero per cent under s. 11.

<sup>85</sup> Exchange Control Regulations as promulgated by Government Notice R.1111 of 1 December 1961 and amended up to Government Notice No. R.9 in Government Gazette No. 33926 of 14 January 2011



securities lending transactions. The SARS has ruled that a gold loan fee is exempt from VAT in terms of sections 2(1)(f) and 12(a) of the VAT Act as the loan of gold is regarded as money's worth and the lending fee takes on the nature of interest. In the same ruling, however, SARS states that a securities lending fee is taxable in terms of the provisions of section 7(1)(a) of the VAT Act.<sup>86</sup>

## Finance Leases and Rentals

For the purposes of this section, only the principles of finance leases and rental agreements are dealt with. For an in-depth analysis of this topic please refer to Installment Credit Sales contained in Chapter 6 - Complex Financial Arrangements. The authority for the levying of VAT is to be found in section 7(1)(a) of the VAT Act. It calls for VAT to be levied 'on the supply by any vendor of goods or services . . . in the course or furtherance of any enterprise carried on by him'.<sup>87</sup> The broad construction of this expression means that the vast majority of transactions subject to VAT will fall within the scope of this particular provision. The authority for the levying of VAT on imported goods and imported services is to be found in sections 7(1)(b)<sup>88</sup> and (c)<sup>89</sup> respectively.

The existence of a supply is the critical precondition for liability. The definition of the term 'supply'<sup>90</sup> states that it:

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.

---

<sup>86</sup> SARS ruling issued to the Banking Association of South Africa dated 27 July 2006.

<sup>87</sup> These are 'taxable supplies'. The term 'taxable supply' is defined in *Value-Added Tax Act No. 89 of 1991*, s. 1, as any supply of goods or services which is chargeable with tax under the provisions of s. 7(1)(a), including tax chargeable at the rate of zero per cent under s. 11.

<sup>88</sup> of Value-Added Tax Act No. 89 of 1991

<sup>89</sup> of Value-Added Tax Act No. 89 of 1991

<sup>90</sup> Definition of 'supply', *Value-Added Tax Act No. 89 of 1991*, s. 1.





The VAT Act thus draws a distinction between instalment credit agreements (generally recognised by their description as ‘instalment sales’ or ‘financial leases’), and rental agreements. An instalment credit agreement includes a sale agreement in respect of corporeal movable goods where the payments are made in instalments over a period of time and a financial lease of corporeal movable goods for a period exceeding 12 months,<sup>91</sup> where the aggregate amounts payable by the purchaser or lessor exceed the cash value of the supply of the goods, and includes finance charges which are stipulated in the agreement. The supply of the use or the right to use any goods under a rental agreement, instalment credit agreement or any other agreement, is expressly deemed to be a supply of goods, and not services.<sup>92</sup>

The VAT on a finance lease is payable upfront by the supplier of the goods upon delivery of the goods or receipt of any payment whichever date is earlier,<sup>93</sup> and the VAT payable is calculated on the cash value of the goods supplied.<sup>94</sup> The finance charges are considered by SARS to be consideration for the provision of credit, which is exempt from VAT in terms of sections 2(1)(f)<sup>95</sup> and 12(a)<sup>96</sup>.<sup>97</sup> But section 8(11)<sup>98</sup> deems the supply of the use or the right to use any goods under any instalment credit agreement to be a supply of goods. It is therefore arguable that the supply of goods under a finance lease comprises a single supply of goods as contemplated by section 8(11)<sup>99</sup> and that the financing element forms an integral part of the leasing activity, the consideration of which is the cash value of the goods supplied.

---

<sup>91</sup> *Value-Added Tax Act No. 89 of 1991*, s. 1(1), definition of ‘instalment credit agreement’.

<sup>92</sup> *Value-Added Tax Act No. 89 of 1991*, s. 8(11).

<sup>93</sup> *Value-Added Tax Act No. 89 of 1991*, s. 9(3)(c).

<sup>94</sup> *Value-Added Tax Act No. 89 of 1991*, s. 10(6).

<sup>95</sup> of *Value-Added Tax Act No. 89 of 1991*

<sup>96</sup> of *Value-Added Tax Act No. 89 of 1991*

<sup>97</sup> SARS ruling issued to the Banking Association of South Africa and dated 27 July 2006.

<sup>98</sup> of the *Value-Added Tax Act No. 89 of 1991*

<sup>99</sup> of the *Value-Added Tax Act No. 89 of 1991*



A 'rental agreement' means any agreement for the letting of goods, but excluding a finance lease as contemplated by the definition of 'instalment credit agreement'.<sup>100</sup> The supplies under a rental agreement are deemed to be made successively when each rental payment becomes due or is received,<sup>101</sup> whichever is earlier, and VAT is payable on the total consideration for each successive payment. The finance charge included in each rental payment is considered to be part of the taxable consideration for the supply of the goods on which VAT is levied. Section 8(11)<sup>102</sup> also deems a supply of the use or right to use any goods under a rental agreement to be a supply of goods.

Such financial products are commonly referred to as 'off balance-sheet financing' as effectively the lessor has obtained a loan, from the financial service provider, to purchase goods or equipment and offered the said goods or equipment as security for the monies borrowed (even though legally ownership hasn't transferred to the borrower/purchaser in most cases).

## **Sundry Services**

There are a number of additional activities which a financial institution may carry out in relation to its lending activities. The consideration for all these activities is generally charged in the form of a fee or commission, and as such they are specifically excluded from the ambit of a 'financial service' and are subject to VAT. Certain complex financial arrangements also involve the use of fees and other methods (such as syndication and profit shares) to compensate for additional credit risk of the borrower. These arrangements are discussed in greater detail in Chapter 6 – Complex Financial Arrangements.

---

<sup>100</sup> *Value-Added Tax Act No. 89 of 1991*, s. 1(1), definition of 'rental agreement'.

<sup>101</sup> *Value-Added Tax Act No. 89 of 1991*, s. 9(3)(a).

<sup>102</sup> of the Value-Added Tax Act No. 89 of 1991



Fees charged for cheque books, statement of accounts, on-line banking fees, bank charges, ATM fees, cash deposit fees, administration fees, structuring fees, breakage fees and investment advice are subject to VAT. Fees charged for security storage services rendered in South Africa are subject to VAT, but to the extent that the securities are stored outside South Africa, these fees qualify for VAT at the rate of zero per cent.<sup>103</sup>

Any fees relating to credit cards, including fees charged for issue of the card and credit card service fees are subject to VAT. Conceptually, a credit card is unsecured finance granted to an individual or a company. Most of these services allow for an 'interest free' period, where the card holder is able to use the card's facility but only settle it up to 55 days later. It is submitted that the fee for provision of the credit card is to some extent, remuneration for the provision of such credit (interest). The difficulty in attributing these fees to 'quasi' interest is that there are other services included in this charge (such as, *inter alia* the processing of card swipes, the cost of a loyalty awards program and recoveries for the support systems) some of which will be taxable supplies. Fees charged to merchants for accepting credit cards as payment for the supply of goods or services are also subject to VAT.

The margin with regard to the exchange of currency is exempt from VAT, whereas any fee or commission for the provision of foreign currency or the exchange of currency is subject to VAT.

Where services are supplied to non-residents, the fees may qualify for the rate of zero percent in terms of section 11(2)(i) provided the non-resident is not present in South Africa when the service is rendered. The Supreme Court of Appeal has ruled that the exchange of currency for a non-resident on the 'airside'<sup>104</sup> of customs at an international airport in

---

<sup>103</sup> In terms of *Value-Added Tax Act No. 89 of 1991*, s. 11(2)(k).

<sup>104</sup> The term refers to the passenger waiting area after the passenger has cleared airport security and passport control



South Africa does not qualify for the zero rate.<sup>105</sup> The rationale employed by the court is that even though the transactions occurred ‘airside’ (after a traveler has passed through passport control) the transaction still occurred within the republic and is therefore not afforded the zero rating.<sup>106</sup>

## Reverse Charges

The design of South Africa’s policy approach is to impose a ‘reverse charge’ on certain inputs acquired from overseas. The reverse charge mechanism combats any distortions arising from the input taxation of financial supplies and addresses the incentive exempt or partially exempt to acquire overseas services which would otherwise not be subject to VAT, by imposing the appropriate amount of VAT on such services.

The authority for the levying of VAT, as noted, is found in section 7(1)(a), while the VAT treatment of imported goods and imported services is found in sections 7(1)(b) and (c) respectively.

The importation of goods, in principle, is subject to VAT at the standard rate, irrespective of whether the importer is conducting an enterprise or otherwise, or the nature of the goods (subject to the exemptions listed in Schedule 1 to the VAT Act), or of the use to which they are to be put. Where the imported goods are used in the making of taxable supplies, the associated VAT qualifies as input tax. The deduction of the input tax is however subject to the importer retaining the release notification and Customs receipt in order to substantiate the deduction<sup>107</sup>.

---

<sup>105</sup> Master Currency v C: SARS (155/2012) 2013 ZASCA 17 (20 March 2013).

<sup>106</sup> In terms of Value-Added Tax Act No. 89 of 1991 s.11(2)(l)

<sup>107</sup> Value-Added Tax Act No. 89 of 1991, s. 16(2)(d).



The term 'imported services', on which VAT is levied in terms of section 7(1)(c), is taken to mean a supply of services made by a supplier who is a resident or carries on business outside South Africa, to a recipient who is a resident of South Africa, to the extent that such services are utilized or consumed in South Africa otherwise than for the purpose of making taxable supplies.<sup>108</sup> The VAT on imported services is payable by the recipient of the service.<sup>109</sup>

The VAT on imported services is payable only to the extent that the services are utilized or consumed in South Africa for purposes other than making taxable supplies. The time of supply is the earlier of invoice or payment.<sup>110</sup> The VAT is then payable on the value of the consideration for the supply, or the open market value, whichever value is greater.<sup>111</sup> To the extent that the services are utilized or consumed for the purpose of making taxable supplies, no VAT is payable.

The provisions of section 7(1)(c) are not applicable, however, where the supply is subject to VAT at the standard rate in terms of section 7(1)(a).<sup>112</sup> Therefore, if the non-resident supplier is registered for VAT in South Africa and is required to levy VAT on the supply at the standard rate in terms of section 7(1)(a), the recipient is not required to pay VAT also on the service acquired under section 7(1)(c). This is to avoid the payment of double tax on the same supply.

The provisions of section 7(1)(c)<sup>113</sup> are also not applicable where the supply, if made in South Africa, would be charged with VAT at the rate of zero per cent in terms of section 11<sup>114</sup> or would be exempt from VAT in terms of section 12.<sup>115</sup> Therefore, where a non-

---

<sup>108</sup> Value-Added Tax Act No. 89 of 1991, s. 1(1), definition of 'imported services'.

<sup>109</sup> In terms of Value-Added Tax Act No. 89 of 1991, s. 7(2).

<sup>110</sup> Value-Added Tax Act No. 89 of 1991, s. 14(2).

<sup>111</sup> Value-Added Tax Act No. 89 of 1991, s. 14(3).

<sup>112</sup> Value-Added Tax Act No. 89 of 1991, s. 14(5)(a).

<sup>113</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>114</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>115</sup> Value-Added Tax Act No. 89 of 1991, s. 14(5)(b).



resident provides credit to a South African borrower, the interest paid on the loan will not be subject to VAT because the loan, if granted in South Africa, would be exempt from VAT in terms of section 12(a). But any fees charged by the non-resident lender to the South African borrower in relation to the loan will be subject to VAT in terms of section 7(1)(c), to the extent that the loan and related services are utilized or consumed by the borrower in South Africa for purposes other than making taxable supplies.

To the extent that a South African resident loan intermediary acquires services from non-residents in respect of its loan intermediary services in South Africa, the loan intermediary will be liable for VAT on any consideration charged by the non-resident in the form of a fee, as such fees would not be exempt from VAT had the services been supplied in South Africa. These fees would include guarantee fees, underwriting fees, facility fees and commitment fees.

Where services acquired from non-residents are utilized or consumed in South Africa partly for the purpose of making taxable supplies and partly for another purpose, VAT is payable in terms of section 7(1)(c) only to the extent that they are utilized or consumed other than for the purpose of making taxable supplies. Unlike input tax (governed by section 17(1) of the VAT Act), there is no prescribed method of apportionment that must be applied to determine the amount of VAT payable on imported services, and therefore any appropriate method can be applied. In practice, the VAT apportionment ratio applied to determine input tax is generally also applied to determine the VAT payable on imported services partially utilized or consumed for purposes of making taxable supplies.

The Tax Court has ruled that services acquired from foreign consultants, foreign business advisers and foreign computer service providers by a life assurance company, comprised imported services on which VAT was payable.<sup>116</sup> The judgment of the Tax Court was

---

<sup>116</sup> Income Tax Case 1812 (68 SATC 208).



upheld by the High Court on appeal.<sup>117</sup> The Supreme Court of Appeal has ruled that services acquired by a South African Company involved in the mining and selling of diamonds, which was subject to a take-over bid and which acquired the services of independent financial advisors to advise the board on whether the offer was fair and reasonable, comprised imported services subject to VAT in terms of section 7(1)(c).<sup>118 119</sup>

## Direct Loan Services

The activities listed in section 2(1) are deemed to be financial services, irrespective of whether or not the entity carrying out the activity is a financial services organization. Consequently, where a borrower sources funding directly from lenders, for example through the issue of bonds, promissory notes or debentures, such activities also comprise financial services which are exempt from VAT.<sup>120</sup> Similarly, where businesses grant loans to intra-group borrowers, such loans are deemed to be financial services if they are interest bearing.<sup>121</sup>

Where a business supplies goods or services on an instalment sale basis or if extended payment terms are offered interest free, the provision of credit in these circumstances falls outside the scope of section 2(1)(f) and is therefore not a financial service. The SARS has recently taken the view that where the terms and conditions of such a sale stipulate that the customer agrees to pay interest in the event of a default on the repayment terms, the provision of credit would fall within the ambit of section 2(1)(f). This view seems to be contrary to the intention of the legislature.<sup>122</sup>

---

<sup>117</sup> Metropolitan Life Company v C: SARS (2008) 70 SATC 162.

<sup>118</sup> Commissioner for SARS v De Beers (503/2011) [2012] ZASCA 103 (1 June 2012).

<sup>119</sup> Adapted from De Koker AP, Bardenhorst G & Kruger D, VAT in South Africa (2016), LexisNexis, South Africa

<sup>120</sup> Value-Added Tax Act No. 89 of 1991, s. 2(1)(c), the issue, allotment, drawing, acceptance, endorsement or transfer of ownership of a debt security.

<sup>121</sup> Value-Added Tax Act No. 89 of 1991, s. 2(1)(f).

<sup>122</sup> VATCOM expressed the view that where a loan of money is made and no interest is charged a service is performed for no consideration. The provision of credit in such a case does not fall within the ambit of s. 2(1)(f) and therefore is not a financial service. The provision of credit for no consideration is thus a taxable supply and no apportionment of input tax would be required.



## Shares

South African jurisprudence has accepted the legal characterization of shares as a 'bundle of rights',<sup>123</sup> that is to say, a conglomerate of personal rights (rights *in personam*), entitling the holder to a certain interest in the company, its assets and dividends;<sup>124</sup> but a share does not give the holder any real right (right *in rem*) in respect of the company's property. A share in the capital of a company or a member's interest in a close corporation is thus a form of incorporeal property. It is a legal construct that has evolved to describe the rights as well as the responsibilities that attend ownership quite independently of whatever 'thing' is owned. It follows that it is possible for the holder to alienate certain of those personal rights whilst retaining others. But it needs to be borne in mind that, for the purposes of the Companies Act, it is only the person whose name is recorded on the securities register who is a 'shareholder'.<sup>125</sup>

The issue, allotment or transfer of ownership of an equity security is deemed to be a financial service for South African VAT purposes<sup>126</sup> and accordingly exempt from VAT,<sup>127</sup> but will be subject to securities transfer tax.<sup>128</sup> The term 'equity security' as so defined in section 1 of the VAT Act means any interest in or right to a share<sup>129</sup> in the capital of a juristic person or a member's interest in a close corporation.<sup>130</sup> In other words, the creation

---

<sup>123</sup> See, for example, *Standard Bank of South Africa Ltd and others v Ocean Commodities Inc and others* 1983 (1) SA 276 (A) at 288H, in which Corbett JA said: 'A share in a company consists of a bundle, or conglomerate, of personal rights entitling the holder thereof to a certain interest in the company, its assets and dividends'. See also *Kommissaris Van Binnelandse Inkomste v Sive se Boedel* 1963 (3) SA 847 (A) at 849A.

<sup>124</sup> *Randfontein Estates Ltd v The Master*, 1909 TS 978, at 981; *Liquidators, Union Share Agency v Hatton*, 1927 AD 240, at 250-251.

<sup>125</sup> Companies Act 71 of 2008 (SA), s. 1, definition of 'shareholder'.

<sup>126</sup> Value-Added Tax Act 89 of 1991 (SA), s. 2(1)(d).

<sup>127</sup> Value-Added Tax Act No. 89 of 1991, s. 12(a).

<sup>128</sup> Value-Added Tax Act No. 89 of 1991, s. 2(2)(iv). The Securities Transfer Tax Act, 2007 calls for securities transfer tax to be levied on the transfer of securities. The Securities Transfer Tax Administration Act, 2007 contains the administration provisions governing the payment of securities transfer tax.

<sup>129</sup> The Companies Act, s. 1, defines the term 'share' as meaning one of the units into which the proprietary interest in a profit company is divided; and the term 'shareholder' as the holder of a share issued by a company and who is entered as such in the certificated or uncertificated securities register, as the case may be.

<sup>130</sup> It is submitted that there is no real difference between the terms 'equity security' and 'equity share', which is defined in the Income Tax Act 58 of 1962 as a share in a company, excluding any share that, neither as respects





and allotment of shares in a company pursuant to an offer of shares for subscription or the disposal of shares in a company is deemed to be a financial service. Section 12(a) exempts from the VAT imposed under section 7(1)(a) the supply of financial services, but excludes financial services which would otherwise have been charged with VAT at the rate of zero percent under section 11.

The Tax Court has held that the provisions of section 12(a) and section 11 apply only to financial services which, but for these provisions, would be charged to tax under section 7(1a) and thus be classified as supplies made in the course or furtherance of an enterprise and be taxable at the standard rate.<sup>131</sup> The application of this principle means that where shares are held as an investment, the mere holding of the shares does not constitute an enterprise and the disposal of these shares will not fall within the ambit of section 7(1)(a), thereby ignoring the provisions of section 12(a) and 11. Such disposal is therefore neither exempt nor zero-rated, and falls outside the scope of VAT.

Any fee, commission or similar charge (but excluding any discounting cost) payable in respect of or in relation to the issue or disposal of shares, is subject to VAT (proviso to section 2(1)). While a fee charged by an underwriter or sub-underwriter in relation to the issue of shares is subject to VAT, the issue of the shares to the underwriter or sub-underwriter remains exempt (section 2(1) (d)).<sup>132</sup>

Brokerage fees charged by stockbrokers are subject to VAT. Although the transfer of ownership of shares is exempt, the fees charged by company transfer secretaries for their services are subject to VAT. Fees charged for the safe custody of share certificates are also subject to VAT. The following activities no longer constitute 'financial services' following an amendment to section 2(1) in 1996, and are subject to VAT:

---

dividends nor as respects returns of capital, carries any right to participate beyond a specified amount in a distribution.

<sup>131</sup> Case No. VAT 382, Tax Court (Cape Town) 13 June 2011, paras. 63 and 71.

<sup>132</sup> See also the Explanatory Memorandum on the Taxation Laws Amendment Bill, 1996, p. 9.



- The underwriting or sub-underwriting of equity securities.
- The renewal or variation of rights attaching to equity securities.
- The provision, taking, variation or release of a guarantee, indemnity, security or bond for the performance of obligations under equity securities or for any of the activities listed in items 1 and 2 above.
- The arranging or agreeing to do any of the activities listed in section 2(1) as financial services and items 1 to 3 above.

An 'equity security' does *not* include a long-term insurance policy, the ownership of or an interest in land, a share in the share capital of a share block company, any time-sharing interest conferred by a member's interest in a close corporation or an interest in a superannuation scheme. The term 'equity security' also does not include a partner's interest in a partnership.<sup>133</sup>

Whether or not a supply comprises an 'equity security', that is to say, an interest in or right to a share in the capital of a juristic person, requires an examination of the company's articles of incorporation to identify the rights which form part of the bundle of incorporeal rights comprising the shares of the company concerned. If the supply does not comprise part of these rights, it will not be considered to be an 'equity security' as so defined and the consideration will attract VAT.<sup>134</sup> Courts of law will not be deceived by the form of a transaction; it will 'rend aside the veil in which the transaction is wrapped and examine its true nature and substance'.<sup>135</sup>

---

<sup>133</sup> A partnership, in terms of the definition of 'person' in section 1, is a separate legal persona in its own right, distinct from the partners, and thus a separate registrable entity for VAT purposes. The disposal by a partner of his or her interest in a partnership and the concomitant transfer of the partnership interest, however, will not constitute a supply in the course or furtherance of any enterprise he or she may be carrying on, since the partnership is regarded as a distinct enterprise and can therefore not form part of the partners' other enterprises.

<sup>134</sup> See TCT Leisure (Pty) Ltd v C: SARS (2010) 3 All SA 325 (SCA), 72 SATC 187.

<sup>135</sup> Wessels ACJ in Kilburn v Estate Kilburn 1931 AD 501 at 507.



In jurisdictions such as South Africa, which have included a general anti-avoidance provision in their VAT (and income tax and capital gains tax) legislation,<sup>136</sup> there is not the same pressure to aggressively develop the common law to deal with unacceptable tax schemes. The contribution of common law principles to the countering of unacceptable tax schemes can therefore be confined to the rule that the courts will not be deceived by a sham or disguised transaction and will give effect to the real transaction and that the courts will have regard to substance rather than form. But where the form of a transaction is cloaked under the mantle of a supply of equity securities, when in fact the true nature is something different, the substance will prevail. In *TCT Leisure (Pty) Ltd v C: SARS*<sup>137</sup> preference shares were sold which purportedly bestowed upon the shareholders certain 'point rights', essentially the right to occupy holiday accommodation. The taxpayer argued that the sale of the preference shares was a single supply and exempt from VAT, being the transfer of an 'equity security' as so defined, whilst SARS contended that in substance timeshare interests were disposed, constituting 'fixed property' as so defined. Cloete JA, who delivered the unanimous decision of the court, held that, in order to succeed, the taxpayer 'would have had to show that the occupation rights formed part of the bundle of incorporeal rights comprising . . . shares . . . which [were] sold to members of the public'.<sup>138</sup> The learned judge found this was not the case and that 'it was not the share interest in the company . . . which entitled the member of the public "to be credited each year with points rights" which, in turn, entitled the member to accommodation rights in terms of the scheme'. What was sold was a composite supply of both shares and points' rights. The fact that the shares and points rights were linked did not, it was held, 'result in a merger of the rights attaching to each, nor [did] it entitle the shareholder *qua* shareholder to exercise the right of a points holder or a points holder

---

<sup>136</sup> See, e.g., Value-Added Tax Act No. 89 of 1991, s. 73.

<sup>137</sup> (2010) 3 All SA 325 (SCA), 72 SATC 187.

<sup>138</sup> *TCT Leisure (Pty) Ltd v C: SARS* (2010) 3 All SA 325 (SCA), 72 SATC 187 at 190.



to exercise the right of a shareholder'.<sup>139</sup> The right to occupy was not supplied as an incident of share ownership, but as a discrete element in the form of points rights, and the latter was a taxable supply subject to VAT.<sup>140</sup>

An undivided interest in a business or in an asset owned by a company is not an 'equity security' and the disposal thereof is not an exempt financial service. The VAT status of such disposal will depend on whether the supplier is a registered vendor and whether that business or asset was applied in the course of a taxable enterprise activity.

## **Securities Lending**

Securities lending refers to the practice by which securities are transferred temporarily from one party (the lender) to another (the borrower) with the latter obliged to return the securities or equivalent on demand or at the end of any agreed term, an arrangement commonly known as a 'securities lending agreement' or 'stock loan'. As payment for the loan, the parties negotiate a securities lending fee, generally quoted as an annualized percentage of the value of the loaned shares. When a share is loaned, the title of the share transfers to the borrower and the borrower therefore becomes the full legal and beneficial owner of the share. Consequently, the borrower receives all dividend payments. Generally, these dividends must be passed back to the lender in the form of what is referred to as a manufactured dividend. At the end of that period, securities which are either the original securities lent, or replacement securities of the same number and type as the original securities are returned to the lender. The borrower pays a securities lending fee for the use of the securities for the period. The transfer of the title of the shares to the borrower upon lending of the shares, and the transfer of title of the shares back to the lender at the end of the lending period, are exempt from VAT in terms of sections 2(1) (d) and 12(a) of the VAT Act. The manufactured dividend falls outside the

---

<sup>139</sup> TCT Leisure (Pty) Ltd v C: SARS (2010) 3 All SA 325 (SCA), 72 SATC 187 at 191.

<sup>140</sup> Adapted from De Koker AP, Bardenhorst G & Kruger D, VAT in South Africa (2016), LexisNexis, South Africa



scope of VAT and as such does not attract any VAT. The securities lending fee is, however, subject to VAT if charged by a VAT-registered lender. If the borrower is a non-resident, the securities lending fee may qualify for the rate of zero per cent. If the lender is a non-resident and the borrower is a resident, then the securities lending fee will be subject to VAT in terms of section 7(1)(c) of the Act, being consideration for an imported service<sup>141</sup>.

The securities lending arrangement may have secondary supplies of interest, which occur where the borrower provides collateral, for example, in the form of interest-bearing securities or certificates of deposit as default security. If the lender temporarily invests the cash collateral in interest-earning deposits or interest-bearing securities, there will be additional exempt supplies in the form of the interest bearing deposits. It is possible that as part of the securities lending agreement, the interest on the certificates of deposit may be shared by both borrower and lender (in which case the borrower has a further exempt supply). If the 'borrower' defaults and the 'lender' retains all or part of the cash collateral, the amount retained represents compensation that falls outside the scope of VAT, being consideration for losses suffered and not for the supply of any goods or services. Any part of the collateral returned to a defaulted borrower also falls outside the scope of VAT, as the payment does not amount to consideration for any supply.

## **Debentures and Debts**

The issue, allotment, drawing, acceptance, endorsement, transfer of ownership of a debt security is deemed to be a financial service, and such activities are not subject to VAT (section 2(1)(c)<sup>142</sup>).

---

<sup>141</sup> Adapted from De Koker AP, Bardenhorst G & Kruger D, VAT in South Africa (2016), LexisNexis, South Africa

<sup>142</sup> of the Value-Added Tax Act No. 89 of 1991



A 'debt security' is widely defined in section 2(2)(iii)<sup>143</sup> as an interest in or right to be paid money that is or is to be owing by any person or an obligation or liability to pay money, but does not include a 'cheque' as defined.<sup>144</sup> The term thus embraces trade debts, loan accounts, promissory notes, interest swaps and a wide variety of other rights to be paid in money or obligations to pay money. The effective consequence is that when a creditor or debtor transfers, say, a debt, the transaction is exempt from VAT, which means that the transfer of accounts receivable and assumption of liabilities on the disposal of a business would be exempt.

The term 'debenture' is not defined in the *VAT Act*, and its meaning is imprecise. 'Securities', as so defined in the Companies Act No. 71 of 2008 ('Companies Act'), includes shares and also includes '...debentures or other instruments, irrespective of their form or title, issued or authorised to be issued by a profit company'. A 'debt instrument' achieves definition<sup>145</sup> and includes any securities of a company, other than shares, but excludes, amongst others, loans. The term 'debt instrument' therefore signifies '... debentures or other instruments, irrespective of their form or title, issued or authorised to be issued by a profit company'. All other 'instruments', such as letters of allotment could then be 'debt instruments' as the disjunctive 'or' in the definition of 'securities' qualifies not only debentures. The word 'includes' in the definition of 'debt instrument' signifies that not only instruments of which debt is an element are included, but that all debentures are debt instruments, but not all debt instruments are debentures.

---

<sup>143</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>144</sup> A 'cheque' is defined in section 2(1) of the Value-Added Tax Act to mean a bill drawn on a bank payable on demand, a postal order, a money order, a traveller's cheque, or any order or authorisation (whether in writing, by electronic means, or otherwise) to a financial institution to credit or debit any account.

<sup>145</sup> Section 43 of the Companies Act 2008 defines the term as follows:

'43. Securities other than shares.—(1) In this section—

(a) "debt instrument"—

(i) includes any securities other than the shares of a company, irrespective of whether or not issued in terms of a security document, such as a trust deed; but does not include promissory notes and loans, whether constituting an encumbrance on the assets of the company or not'.



A debenture of a body is a chose in action (an intangible personal property right recognized and protected by the law that has no existence apart from the recognition given by the law) that includes an undertaking by the body to repay a debt, money deposited with or lent to the body.<sup>146</sup> The word 'debenture' has been interpreted to mean any document, however it may be described, and whatever form it may take, which imports or acknowledges indebtedness in the company to another for monies advanced or to be advanced to the company.<sup>147</sup>

In *Randfontein Estates Gold Mining Co Ltd v Custodian of Enemy Property*,<sup>148</sup> Innes CJ described a bearer debenture as 'an acknowledgment of debt in favour of the holder as a creditor of the company for the specified amount with a right to interest therein as stipulated'. Although the rights conferred by a debenture on a debenture-holder differ in content from those enjoyed by a shareholder, similar considerations apply to the registration of debenture-holders, the issue of debenture certificates and the holding of a debenture by a nominee.

Section 2(1)(c) of the VAT Act also has the effect of exempting the cession or factoring of debts. But the definition of 'financial services' does not embrace the waiver of a debt and presumably it would be subject to VAT to the extent of any consideration received. Where debts that originated from a taxable transaction and thus include a VAT component are transferred on a recourse basis, the transferor may claim bad debt relief when such debts become irrecoverable, are transferred back to the transferor and are written off as irrecoverable.<sup>149</sup> The bad debt relief that may be claimed is the tax fraction ( $\frac{14}{114}$ ) of the cash value of the supply that has become irrecoverable. No relief may be claimed by the transferor if the debts are transferred on a non-recourse basis.<sup>150</sup> The

---

<sup>146</sup> *Bacal Contracting Ltd v Modern Engineering (Bristol) Ltd and others* [1980] 2 All ER 655.

<sup>147</sup> *Coetzee v Rand Sporting Club* 1918 WLD 74.

<sup>148</sup> 1923 AD 576.

<sup>149</sup> Value-Added Tax Act, 1991, s. 22(1)(c) proviso (iv)(bb).

<sup>150</sup> Value-Added Tax Act, 1991, s. 22(1)(c) proviso (iv)(aa).



transferee may, however, claim the bad debt relief but it is limited to the amount originally paid by the transferee in respect of the face value of the debt.<sup>151</sup>

The cession of debtors is not an exempt financial service if such cession would result in no output tax being paid by the vendor concerned (section 2(4)(a)<sup>152</sup>). For example, where a vendor who, accounts for VAT on the payments basis cedes a debt before payment is received, output tax in respect of such supply will not become payable by the vendor. In these circumstances the cession of the debt is not exempt and will be subject to VAT.

Debts, shares and unit trust interests do not include life or other insurance policies; interests in land other than a mortgage; shares in share-block companies and interests in time-sharing schemes under the respective controlling Acts; or any interest in a superannuation scheme.

Any fee, commission or similar charge (but excluding any discounting cost) payable in respect of or in relation to the issue, allotment, drawing, acceptance, endorsement, transfer of ownership of a debt security, is subject to VAT (proviso to section 2(1)<sup>153</sup>).

The term 'discounting cost' is not defined. 'Discount' is defined as follows in the *Encarta Dictionary: English (UK)*:

'reduction in price' a reduction in the usual price of something

'interest deducted from financial instrument' the interest deducted from the face value of a financial instrument or promissory note before a sale or loan is completed

'deduction from par value of shares' the amount by which the par value of shares exceeds the market price actually paid by purchasers.

---

<sup>151</sup> Value-Added Tax Act, 1991, s. 22(1) proviso (1A).

<sup>152</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>153</sup> of the Value-Added Tax Act No. 89 of 1991





Where a transferor (cedent) of a debt security incurs a discounting cost and divests him- or herself of the right to claim the attendant income in the future, the cost incurred by the cedent is equal to the transferee's (cessionary's) discounting income. For example, if a cedent cedes a book debt of ZAR 100 to a bank thereby transferring the obligation of the debtor from him- or herself to the cessionary, and the latter pays ZAR 90, the difference of ZAR 10 is a discounting fee charged by the bank.

According to the Banking Services Schedule,<sup>154</sup> the discounting fee charged for the discounting of bills, letters of credit, bankers' acceptances, promissory notes and accounts receivable represents consideration for the supply of an exempt financial service. No VAT is charged on the discounting fee by the cessionary (the bank), and the cedent is not entitled to any deduction in respect of the discounting cost (which normally includes factoring cost, as factoring is merely a form of cession of book debts).

While the discounting cost is expressly excluded from a taxable fee, commission, merchant's discount or similar charge, the service rendered by a bank when discounting a bill, letter of credit, promissory note or book debt is not a financial service. SARS in practice treats the discount as exempt in terms of section 2(1)(c)<sup>155</sup>, but this interpretation may not be correct as the service rendered by the cessionary of a debt security is not covered by the wording of the provision in question. Only the transfer of ownership of the debt security by the cedent to the cessionary falls within the ambit of section 2(1)(c)<sup>156</sup>. On the other hand, if the principle laid down in *Commissioner for South African Revenue Service v Cape Consumers (Pty) Ltd*<sup>157</sup> is applied to discounting, the amount of the discount is merely a profit made by the bank should it collect the full amount owing by the

---

<sup>154</sup> Entitled 'Banking Services Provided and Fees which may be Charged in Connection With Such Services', prepared by the Indirect Tax Standing Committee of the Banking Association South Africa, and approved by SARS, revised and agreed on 2 March 2006 and effective as from 1 March 2006. Any such document issued in the future will have the status of a binding class ruling in terms of s. 41B of the Value-Added Tax Act which will have the same binding effect as a binding class ruling issued under s. 78 of the Tax Administration Act 28 of 2011.

<sup>155</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>156</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>157</sup> (61 SATC 91), 23 March 1999.



debtor. On this basis the discount is not consideration for any supply made by the bank, and is in any case not subject to VAT, but not for the reason advanced by SARS.

## Collective Investment Schemes

The issue, allotment or transfer of ownership of a participatory security is deemed to be a financial service and accordingly exempt from VAT (section 2(1)(d)<sup>158</sup>).

The term 'participatory security' is defined as encompassing a 'participatory interest' as defined in section 1 of the *Collective Investment Schemes Control Act*<sup>159</sup> but does not include an equity security, a debt security, money or a cheque (section 2(2)(vi) of the VAT Act). 'Participatory securities' also do *not* include insurance policies, ownership or interest in land, a share in the share capital of a share block company, time-sharing interests or an interest in a superannuation scheme (section 2(3)<sup>160</sup>).

A 'participatory interest', as defined in section 1 of the *Collective Investment Schemes Control Act*<sup>161</sup>, is:

'any interest, undivided share or share whether called a participatory interest, unit or by any other name, and whether the value of such interest, unit, undivided share or share remains constant or varies from time to time, which may be acquired by an investor in a portfolio.'

The term 'portfolio', in turn, is defined as:

'a group of assets including any amount of cash in which members of the public are invited or permitted by a manager to acquire, pursuant to a collective investment scheme, a participatory interest or a participatory interest of a specific class which as a result of its specific characteristics differs from another class of participatory interests.'

---

<sup>158</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>159</sup> Act 45 of 2002.

<sup>160</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>161</sup> Collective Investment Schemes Control Act No. 45 of 2002



Any fee, commission or similar charge, excluding any discounting cost payable in respect of the issue, allotment or transfer of ownership of a participatory security is taxable (proviso to section 2(1)<sup>162</sup>). The creation of new units is exempt but all fees, such as the initial fees, exit fees and annual management fees, are subject to VAT.

Where the management company repurchases units and then disposes of those same units before they are cancelled, the margin between the purchase and selling price which accrues to the management company does not constitute a 'fee, commission or other charge', and is not subject to VAT.

A so-called trail commission paid to financial advisors out of the management company's annual management fee is subject to VAT.

Hedge funds are regulated in terms of the existing legislative framework provided by the Collective Investment Schemes Control Act<sup>163</sup> and specifically as a scheme declared by the Minister of Finance under section 63 of that Act. The Draft Regulations<sup>164</sup> define a 'hedge fund' as:

'...a collective investment scheme which uses any strategy or takes any position which could result in the portfolio incurring losses greater than its aggregate market value at any point in time, and which strategies or positions include, but are not limited to –

leverage; or

net short positions.'

The services rendered by investment managers to non-resident investors will qualify for zero-rating under section 11(2)(l)<sup>165</sup>. The exclusion of participatory securities from section 11(2)(l)(ii)<sup>166</sup> is not from the zero rating, but from the movable property in respect of which the services relate. In other words, if the services are rendered directly in relation to a

---

<sup>162</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>163</sup> Collective Investment Schemes Control Act No. 45 of 2002

<sup>164</sup> GN 141 GG 38503 of 25 February 2015: Declaration of hedge fund business as a Collective Investment Scheme.

<sup>165</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>166</sup> of the Value-Added Tax Act No. 89 of 1991



participatory securities (being movable property) in South Africa, the zero-rating will apply even if the participatory securities are located in South Africa, as it is excluded from the movable property referred to in section 11(2)(l)(ii)<sup>167</sup>.

In order for zero-rating to apply, the following important considerations should be borne in mind:

- The services must be supplied to a person who is not a resident for VAT purposes. The definition of 'resident' in the VAT Act includes a person who carries on an enterprise or other activity in South Africa and has a fixed or permanent place in South Africa relating to such enterprise or activity.
- Where the assets that are managed by an investment manager for a non-resident constitute South African assets (for example, shares in South African companies or bonds issued by South African companies), the zero-rating will find application only if such assets constitute 'debt securities', 'equity securities' or 'participatory securities'. These are defined concepts and although fairly wide in application, may not encompass certain types of derivative instruments.

## Derivatives

The buying or selling of any derivative or the granting of an option is deemed to be an exempt financial service (section 2(1)(k)<sup>168</sup>).

A 'derivative' as defined in section 2(2)<sup>169</sup> refers to the definition of 'derivative' as defined in International Accounting Standard 39 of the International Accounting Standards issued

---

<sup>167</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>168</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>169</sup> of the Value-Added Tax Act No. 89 of 1991



by the International Accounting Standards Board <sup>170</sup> is a financial instrument or other contract within the scope of this Standard with all three of the following characteristics:

- its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying asset');
- it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and
- it is settled at a future date.

A derivative, broadly speaking, is therefore an instrument the value of which is dependent, directly or indirectly, upon the value of some other asset or index.

The supply of the underlying goods or services is deemed to be a separate supply from the supply of the derivative. The VAT status of the supply of such underlying goods or services depends on the nature of the goods or services supplied. If the underlying asset supplied is itself a financial service (such as shares) the supply is exempt from VAT. If the supply of the underlying asset is not specifically exempt, it will either be subject to VAT (such as a precious metal) or zero rated (for example petroleum oil). The underlying supply is deemed to take place at open market value thereof - in other words, not at the option strike price. <sup>171</sup>

---

<sup>170</sup> Value-Added Tax Act, 1991, s. 2(2)(iiiA).

<sup>171</sup> Value-Added Tax Act, 1991, first proviso to s. 22(1)(k).



## Long-term Insurance Policies

The provision or transfer of ownership of a long-term insurance policy or the provision of reinsurance for any such policy constitutes a financial service<sup>172</sup>. The term 'long-term insurance policy' is defined (section 2(2)(v))<sup>173</sup> as 'any policy of insurance issued in the ordinary course of carrying on long-term insurance business as defined in section 1 of the *Long-term Insurance Act, 1998* (Act No. 52 of 1998)'. The term 'long-term insurance policy' would include assistance policies, disability policies, fund policies, health policies, life policies and sinking policies (as defined in section 1 of the *Long-term Insurance Act*).

A 'sinking fund policy' is defined in section 1 of the *Long-term Insurance Act* to mean a contract, other than a life policy, in terms of which a person, in return for a premium, undertakes to provide one or more sums of money, on a fixed or determinable future date, as policy benefits. Therefore, where a person or concern invests an amount of money in a policy underwritten by a long-term insurer, the issue of such investment policy is exempt from VAT, being the supply of a financial service.

The *Long-term Insurance Act* defines a 'fund policy' to mean a contract in terms of which a person, in return for a premium, undertakes to provide policy benefits for the purpose of funding in whole or in part the liability of a fund to provide benefits to its members in terms of its rules, other than such a contract relating exclusively to a particular member of the fund or to the surviving spouse, children, dependents or nominees of a particular member of the fund. Therefore where a superannuation fund insures its liabilities to provide benefits to its members with a long-term insurer in terms of a fund policy, the issue of the fund policy is exempt from VAT as this meets the definition of a financial service. However, the provision of a long-term insurance policy is deemed not to be a financial service 'to the extent that it includes the management of a superannuation

---

<sup>172</sup> section 2(1)(i) of the Value-Added Tax Act)

<sup>173</sup> of Value-Added Tax Act No. 89 of 1991



scheme' (proviso to section 2(1)(i)<sup>174</sup>). The practical effect of this exclusion is that the provision of the policy is exempt, but to the extent that activities of the long-term insurer in relation to the policy involve the management of a superannuation scheme, those activities are subject to tax. Section 10(22A)<sup>175</sup> of the *VAT Act* provides that the value on which VAT must be accounted for on these management activities is the greater of the cost of providing the management services or any consideration charged for the supply thereof. In terms of a ruling issued by SARS to the Association for Savings and Investment South Africa<sup>176</sup> the taxable management activities in relation to a superannuation scheme are legal services rendered to the fund, reporting in respect of the fund, member communication, secretarial services and the provision of the venue for trustee meetings and independent trustees<sup>177</sup>.

Only the provision of long-term insurance policies is exempt from tax. The provision of guarantees, indemnities, securities and bonds for the performance of obligations under debt securities, equity securities or participatory securities is subject to tax with effect from 1 October 1996<sup>178</sup> and any amount, such as a premium paid for such cover is subject to tax.

## Ancillary Services

The activities which are listed as being financial services in section 2(1)<sup>179</sup> are deemed by the proviso to section 2(1)<sup>180</sup> not to be financial services to the extent that the consideration payable for such activities is payable in the form of any fee or commission. But this exclusion from financial services does not extend to the provision or transfer of

---

<sup>174</sup> of Value-Added Tax Act No. 89 of 1991

<sup>175</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>176</sup> Value-Added Tax class ruling entitled Management of Superannuation Schemes: Long-term Insurers issued on 11 September 2011.

<sup>177</sup> Adapted from De Koker AP, Bardenhorst G & Kruger D, *VAT in South Africa* (2016), LexisNexis, South Africa

<sup>178</sup> Section 2(1)(h), repealed by s. 19(1)(c) of the Taxation Laws Amendment Act 37 of 1996.

<sup>179</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>180</sup> of the Value-Added Tax Act No. 89 of 1991



ownership of a long-term insurance policy or other policy of insurance, the provision or transfer of ownership of a superannuation scheme or the buying or selling of any derivative or the granting of an option.

Therefore, essentially all explicit fees charged in relation to the supply of financial services are subject to VAT. Consequently all fees incurred by suppliers of financial investments and by investors are subject to VAT. Such fees would include legal fees, accounting fees, brokerage, advisory fees, underwriting fees, safe custody fees and transfer secretary fees. Where management services are rendered by a long-term insurer to a superannuation scheme under a fund policy, such management services are also subject to VAT on the greater of the value of the cost incurred in providing the management services or the actual fee charged for the services rendered.





## Chapter 4- Input Tax

A vendor is required to account for output tax on taxable supplies made, but is entitled to deduct from this liability the associated input tax incurred. The relevant part of the term 'input tax', as so defined in section 1 of the *VAT Act*, may be paraphrased as follows:

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

- (a) the tax charged under section 7<sup>[181]</sup> and payable by—
  - (i) a supplier on the supply of goods or services made by him to the vendor;  
or
  - (ii) the vendor on the importation of goods; or
  - (iii) the vendor where goods manufactured in South Africa are subject to excise duty or environmental levy but have been sold in bond at a price excluding duty (VAT is then due on the excise duty and environmental levy when paid and is payable to SARS at that time);
- (b) the tax fraction (at the time of the supply) of the lesser of the consideration in money *and* the open market value of the supply (not being a taxable supply) by way of a sale by a resident of any second-hand goods situated in the Republic; and
- (c) the tax fraction of the consideration in money for the supply (not being a taxable supply) by a debtor to the vendor of goods repossessed under an instalment credit agreement or a surrender of goods,

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

---

<sup>181</sup> VAT is charged on the supply of goods or services in the course or furtherance and termination of a registered 'enterprise'. Section 7 calls for the tax:

'... [to] be levied and paid ... [and] to be known as the value-added tax—

(a) on the supply by any vendor of goods or services supplied by him ... in the course or furtherance of any enterprise carried on by him'.



goods or services are acquired by the vendor partly for such purpose, to the extent that the goods or services concerned are acquired by the vendor for such purpose.

In summary, input tax is the VAT incurred in respect of taxable supplies made to the vendor, goods imported and used in the making of taxable supplies, and, in certain circumstances, VAT on excise duty payable. The term also includes the notional tax deemed to have been incurred on second-hand goods acquired and the deemed VAT on repossessed or surrendered goods. The term 'notional tax' constitutes the so-called tax fraction ( $\frac{14}{114}$ ) of a payment or an amount of deemed consideration.

A vendor will be entitled to a deduction of input tax incurred if the goods or services have been acquired wholly or partly for the purpose of consumption, use or supply in the course of making taxable supplies. Where goods or services are acquired *partly* for the purpose of making taxable supplies and partly for some other purpose (for example, exempt supplies or private use), the vendor will be entitled to deduct the VAT incurred on the acquisition of such goods or services only *to the extent* that they will be consumed, used or supplied in the course of making taxable supplies, which requires a segregation of creditable input VAT from non-creditable VAT. The extent to which input tax is deductible must be calculated by means of a ratio determined by the Commissioner in terms of a binding general ruling<sup>182</sup> or section 41B of the *VAT Act*.<sup>183</sup> Unless SARS has specifically approved another method, the turnover-based method is the prescribed basis of apportionment and must be applied when calculating the portion of deductible input tax in respect of 'mixed expenses'.<sup>184</sup>

---

<sup>182</sup> See Ch. 7 of the Tax Administration Act 28 of 2011.

<sup>183</sup> That is, a VAT class ruling or a VAT ruling.

<sup>184</sup> Binding General Ruling 16 (Issue 2) entitled 'Standard Apportionment Method' and dated 30 March 2015. Since April 2000, SARS has prescribed one standard method of apportionment (the turnover-based method) in the Guide for Vendors VAT 404, to be used with effect from 1 November 2000. SARS confirms that the formula in respect of the



The prescribed turnover method uses the proportion of taxable supplies (excluding VAT) to total supplies (excluding VAT) made during a tax period as the appropriate measure. In determining these ratios, the cash value of goods acquired and resupplied under an instalment credit agreement (typically by a bank) must be excluded, as must the value of supplies of capital goods, and the value of goods or services supplied for which an input credit was denied (such as passenger motor cars and entertainment expenses). In the case of certain banks, the value of exempt supplies to be included in the denominator of the apportionment formula is the net margin of interest earned less interest paid. The value of total supplies includes the consideration for taxable supplies, exempt supplies and other 'non-supplies'. The value of total supplies therefore includes, e.g., interest, dividends received and foreign exchange gains. Companies holding investments or those actively involved in importing and exporting are required to monitor income streams to determine whether apportionment is required.

While the mechanism for crediting input tax presents relatively few difficulties for taxable persons who make only taxable supplies, two exceptions arise.

The first exception is relieve the compliance burden in apportioning inputs. An input tax apportionment calculation is not necessary in terms of the *de minimis* threshold supply rule (proviso (i) to section 17(1)<sup>185</sup>). Where the *intended* use of the goods or services in the course of making taxable supplies is equal to not less than 95% of the total intended use, the goods or services are treated as having been acquired *wholly* for the purpose of making taxable supplies within the definition of the law. That is to say, when exempt use does not exceed 5%, it is ignored and full credit is claimed. SARS, in practice, applies the threshold limit to the total of all inputs and not on each input separately.<sup>186</sup>

---

turnover-based method of apportionment as set out in Binding General Ruling 16 constitutes a binding general ruling, issued in accordance with s. 89 of the Tax Administration Act.

<sup>185</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>186</sup> This *de minimis* rule does not apply in reverse: if the exempt use of a particular input amounts to, for example, 96% of overall use, 4% of the VAT incurred may be claimed as a credit.



The second exception is where goods or services are acquired exclusively for the making of exempt supplies or for non-taxable purposes, no VAT is levied on outputs and no input credits are permitted. The effective consequence is that the organization must bear the input tax component as an additional cost.

The VAT incurred on the acquisition of goods or services, consistent with the principles noted above, would therefore ordinarily qualify as 'input tax' unless the goods or services are acquired for making of exempt supplies or for a non-taxable purpose. It matters not if the specific goods or services are not on-supplied (disposed of) by the organization. It is sufficient if the goods or services are acquired for the *purpose* of consumption, use or supply in the course of making taxable supplies.

Alternative apportionment methods include the floor area of a building, transaction volumes, varied input<sup>187</sup> or number of personnel employed in different divisions. Where a vendor intends to use an alternative apportionment method, an application for a ruling, containing the relevant background and financial information (together with reasons why the alternative method should be considered) must be lodged with SARS. Any such approved basis may be changed only with effect from a future date. If considered equitable, SARS may approve a special apportionment method retrospectively to the commencement of the vendor's current year of assessment (in the case of a normal 'income' taxpayer) or the beginning of the vendor's financial year (if not income tax registered).<sup>188</sup>

Where a series of successive supplies occurs, it may be difficult to determine the proportion of taxable to exempt use at the beginning. In such a situation, a best estimate

---

<sup>187</sup> The ratio taxable expenses incurred wholly for the purpose of making taxable supplies to the total of taxable expenses incurred wholly for the purpose of making taxable supplies plus taxable expenses incurred wholly for the purpose of making exempt supplies.

<sup>188</sup> Section 17(1)(iii) of the Value-Added Tax Act. All rulings issued before 1 January 2007 have been withdrawn, unless the vendor applied for reconfirmation within the required period. If SARS did not reconfirm a ruling by October 2011, the ruling is no longer valid.



should be made of the proportion of input tax to be deducted as each successive consideration is invoiced or payment is received; and an adjustment by way of additional output or input tax made at the end of the series, when the proper proportion of use can be determined.<sup>189</sup> In other words, the estimate must be adjusted when the final successive supply takes place in the final tax period. If the creditable input tax was overestimated, the excess must be accounted for as output tax; if underestimated, the shortfall qualifies as input tax.

In ITC 1744<sup>190</sup> a container manufacturer incurred VAT on professional services in arranging the allotment of shares in order to raise working capital in the venture capital market. It sought to deduct the VAT as input tax on the basis that in the absence of raising the capital, it would not be able to manufacture containers and that, accordingly, a sufficiently close connection existed between the expenditure and the making of taxable supplies. The Commissioner rejected the vendor's claim on the basis that the allotment, issue and transfer of equity securities constitutes the supply of financial services, which are exempt. The Court held that the raising of capital was of a preparatory nature and the related expenditure could not be regarded as having been incurred in the course of manufacturing the containers. Conradie J, delivering the decision of the Tax Court, citing with approval the decision of the European Court of Justice in *BLP Group plc v Commissioners of Customs and Excise*,<sup>191</sup> held that where goods or services were used for an exempt supply, it was not legitimate for the taxpayer to look through that supply to the ultimate purpose of carrying out taxable supplies.

It is questionable whether the principles in *BLP Group* are still applicable in view of the subsequent European Court of Justice (ECJ) judgments such as *Kretztechnik AG v*

---

<sup>189</sup> Section 17(1)(ii) of the Value-Added Tax Act.

<sup>190</sup> (2002) 65 SATC 154.

<sup>191</sup> [1996] 1 WLR 174.



*Finanzamt Linz*<sup>192</sup> and *Skatteverket v AB SKF*,<sup>193</sup> and the judgment of the Tax Court in Case VAT 382.<sup>194</sup> By classifying a share issue as a non-supply, the inputs attributable to the share issue would be recoverable in the same way (and to the same extent) as VAT incurred on general overheads.

Consistently with this analysis, where a company carries on a fully taxable business and issues shares or debt, the VAT associated with the issue will be fully recoverable. Where the company makes taxable and exempt supplies (for example, banking or insurance) the VAT associated with the share or debt issue will be partially recoverable.

The Supreme Court of Appeal has ruled that services acquired by a company involved in the mining and selling of diamonds, which was subject to a take-over bid and who acquired the services of lawyers and accountants to enable the board to advise shareholders on the reasonability of the offer, comprised expenses incurred in relation to a shareholder function unrelated to its taxable activities of mining and selling diamonds, and as such the VAT incurred thereon did not qualify as input tax.<sup>195</sup>

In *KCM v C: SARS*<sup>196</sup> the court held that the distribution of religious material free of charge is purely gratuitous and cannot constitute taxable supplies as it falls outside the ambit of an 'enterprise'. Because the distribution of goods free of charge does not qualify as taxable supplies, the court found that no input tax may be claimed on the printing and distribution of the material.

---

<sup>192</sup> Case C-465/03; [2005] STC 1118; [2005] 1 WLR 3755.

<sup>193</sup> Case C-29/08.

<sup>194</sup> Case No. VAT 382, Tax Court Cape Town, 13 June 2011, paras. 63 and 71.

<sup>195</sup> Commissioner for SARS v De Beers (503/2011) [2012] ZASCA 103 (1 June 2012).

<sup>196</sup> (VAT 711) [2009] ZATC 2 (14 August 2009).



## Apportionment for Financial Loan Intermediaries

The right to recover the associated input tax is determined with reference to the amounts of taxable (including zero-rated) and exempt supplies, which means that inputs must specifically be apportioned to outputs, including financial services. Financial service providers supplying a combination of exempt and taxable services are obliged to allocate input credits between exempt (margin) services and taxable activities.

The relevant part of the term 'input tax', as so defined in section 1<sup>197</sup>, reads as follows:

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

(a) the tax charged under section 7<sup>198</sup> and payable by—

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

where the goods or services concerned are acquired by the vendor wholly for the purpose of consumption, use or supply in the course of making taxable supplies or, where the goods or services are acquired by the vendor partly for such purpose, to the extent that the goods or services concerned are acquired by the vendor for such purpose.

A vendor will therefore be entitled to a credit of input tax incurred if the goods or services have been acquired wholly or partly for the purpose of consumption, use or supply in the course of making taxable supplies. Where goods or services are acquired partly for the purpose of making taxable supplies and partly for some other purpose (for example, exempt supplies or private use), the vendor will be entitled to deduct the tax incurred on the acquisition of such goods or services only to the extent that they will be consumed, used or supplied in the course of making taxable supplies, which requires a segregation of creditable input VAT from non-creditable VAT. The extent to which input is deductible

---

<sup>197</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>198</sup> of the Value-Added Tax Act No. 89 of 1991



must be calculated by means of a ratio determined by the Commissioner in terms of a binding general ruling<sup>199</sup> or section 41B of the *VAT Act*.<sup>200</sup>

If the apportionment ratio yields a result of not less than 95%, the goods or services concerned are regarded as having been acquired wholly for the purpose of making taxable supplies and the total amount of VAT may be deducted as input tax.<sup>201</sup>

The Commissioner has issued a binding general ruling in which it is stipulated that the turnover-based method is the prescribed basis of apportionment that must be applied as the default method when calculating the portion of deductible input tax in respect of 'mixed expenses',<sup>202</sup> unless SARS has specifically approved another method. The turnover method uses the proportion of the gross value of taxable supplies to the gross value of total supplies (both amounts excluding VAT) made during a tax period including the value of non-supplies (such as dividends received) as the appropriate measure. Any receipts of a capital nature must be excluded from the formula<sup>203</sup>.

SARS has also issued a class ruling<sup>204</sup> approving an alternative method of apportionment for certain members of the Banking Association South Africa. These vendors may apply the following method in determining the apportionment ratio:

---

<sup>199</sup> Tax Administration Act 28 of 2011, Ch. 7.

<sup>200</sup> That is, a VAT class ruling or a VAT ruling.

<sup>201</sup> Value-Added Tax Act No. 89 of 1991, proviso (i) to s. 17(1).

<sup>202</sup> Binding General Ruling 16 (Issue 2) entitled 'Standard Apportionment Method' and dated 30 March 2015. Since April 2000, SARS has prescribed one standard method of apportionment (the turnover-based method) in the Guide for Vendors VAT 404, to be used with effect from 1 November 2000. SARS confirms in its Guide for Vendors that the formula in respect of the turnover-based method of apportionment constitutes a binding general ruling as contemplated in Binding General Ruling 16 (dated 25 March 2013), issued in accordance with s. 89 of the Tax Administration Act, and is effective from 1 April 2013.

<sup>203</sup> Adapted from De Koker AP, Bardenhorst G & Kruger D, VAT in South Africa (2016), LexisNexis, South Africa

<sup>204</sup> Issued in terms of s. 41B of the Value-Added Tax Act read with Ch. 7 of the Tax Administration Act on 2 June 2015 and effective for financial years commencing on or after 1 July 2015. It modifies the VAT class ruling issued by the Commissioner on 7 December 2011 and modified on 21 November 2012 and is subject to the conditions and assumptions set out in the said VAT class ruling.





$$Y = \frac{A}{A+B} \times 100$$

where –

$Y$  = the apportionment ratio relating to taxable supplies;

$A$  = the value of all taxable supplies subject to VAT in terms of section 7(1)(a)<sup>205</sup>(excluding VAT) as calculated using various guidelines);

$B$  = the sum of exempt supplies made during the period and all other amounts of income which accrued during the period (whether in respect of a supply or not), as calculated using the guidelines discussed below. Specifically excluded is the value of those supplies taken into consideration in determining 'A'.

For the purposes of the above formula, 'A' excludes:

- (i) the cash value of goods supplied under an instalment credit agreement;
- (ii) the portion of the rental payments relating to the capital value of goods supplied under a rental agreement which is entered into as a mechanism of finance (rental payments must be reduced by the cost of funding pertaining to these agreements);
- (iii) consideration received in respect of the disposal of capital assets (whether fixed or movable);
- (iv) consideration received from the disposal of business activities;
- (v) change-in-use adjustments;
- (vi) deemed supplies in respect of insurance indemnity payments to the extent that the indemnity payments relate to extraordinary income; and
- (vii) extraordinary income.

---

<sup>205</sup> of the Value-Added Tax Act No. 89 of 1991



Adjusted values include a 3-year moving average of the net trading margin from taxable (including zero-rated) financial asset trading activities, and zero-rated interest income must be reduced with the cost of funding allocated to such income. Specific inclusions are the gross proceeds resulting from the disposal of properties in possession and reposessions.

'B' represents the value of exempt supplies made as well as any other income generated during the financial year, whether in respect of a supply or not, adjusted with the following exclusions:

- (i) extraordinary non-taxable income;
- (ii) the capital value of loans;
- (iii) fair value gains and losses reflected as income for Financial Reporting Standards purposes;
- (iv) foreign exchange gains and losses not subject to any hedging activities.

It is also subject to the following adjusted values: dividend income, the inclusion of a 3-year moving average of the net trading margin from financial asset trading activities and a reduction of interest income with the cost of funds allocated to such income. The ruling notes that where a vendor finds that the inclusion of dividends unfairly distorts the ratio, the vendor may apply to SARS for an alternative arrangement relating to the inclusion or exclusion of such dividend income.

Where a financial institution is not listed as a member in the class ruling issued by SARS to the Banking Association of South Africa, the financial institution must either apply the prescribed turnover-based method of apportionment,<sup>206</sup> or the financial institution must apply to SARS for a private binding ruling to apply an alternative apportionment method.

---

<sup>206</sup> As set out in Binding General Ruling 16.



## Apportionment for Input Tax – Direct Loan Services

Where a business sources funding directly from a lender or grants interest-bearing loans to intra-group borrowers, such activities are exempt financial services and any VAT on expenses incurred by the business attributable to these VAT exempt activities is not deductible as input tax. The VAT on expenses which are not wholly or exclusively attributable to the making of taxable supplies (typically overhead expenses) therefore needs to be apportioned.

The prescribed method of apportionment is a turnover-based method which is described in Binding General Ruling 16. The application of this method of apportionment is compulsory unless the Commissioner has granted written approval for the application of an alternative apportionment method. The prescribed turnover-based method of apportionment provides as follows:

$$Y = \frac{A}{(A + B + C)} \times 100$$

where –

- Y = the apportionment ratio relating to taxable supplies;
- A = the value of all taxable supplies including deemed taxable supplies, made during the tax period;
- B = the sum of exempt supplies made during the tax period; and
- C = the sum of any other amounts not included in 'A' or 'B' in the formula, which were received or which accrued during the period (whether in respect of a supply or not).

It is specifically stated that C in the formula includes items such as dividends and statutory fines. The value of any capital goods or services supplied, unless supplied under a rental



agreement or operating lease, must be excluded. If the formula yields a ratio of 95% or more, then the total amount of VAT may be claimed as input tax.

The value of taxable and exempt supplies and the amounts in respect of non-supplies to be included in the formula are the gross amounts received during the tax period. This includes interest received on the investment of surplus funds, realized and unrealized foreign exchange differences and the gross proceeds on the disposal of investments not held on capital account.

The application of the prescribed apportionment formula is onerous for most entities that also supply financial services in the course of their business activities and it often necessitates the application for approval of an alternative apportionment method. Where businesses borrow funds to on-lend to intra-group borrowers (a common practice in large entities which have a central treasury), SARS tends to approve an alternative turnover-based apportionment method where the net interest (interest received /less interest paid) is included in the denominator of the formula. If the investment of surplus funds or foreign exchange risks are not actively managed, SARS also tends to approve an alternative turnover-based apportionment method where the interest received on such investments or the foreign exchange differences are excluded on the basis that they are passive in nature<sup>207</sup>.

---

<sup>207</sup> Adapted from De Koker AP , Bardenhorst G & Kruger D, VAT in South Africa (2016), LexisNexis, South Africa



## Chapter 5 - VAT In A Web of Transactions

Consumers transacting in the economy of today often (whether they are aware or not) purchase a service or multiple services along with goods. The sellers of these goods often bundle the goods and services in what resembles a 'web' of transactions rather than a linear chain. It is submitted that where a chain of transactions occur, it is relatively simple to determine the output and input tax effects as the supply is made directly to the person who is liable for the payment in respect of such supply<sup>208</sup>. Consider the following example:

Mr X wishes to subscribe to a satellite based television service. The said service requires Mr X to purchase propitiatory hardware in order to receive the radio signal from the satellite. The local electronic store sells this hardware but also includes with the sale a 'free installation package'. Mr X purchases the hardware from this store and as advertised, the store arranges and completes the installation of this hardware by outsourcing this to a contractor with the relevant expertise.

Here Mr X has purchased both goods and a services, the goods being the hardware required to receive the satellite signal and the services being the installation of the said hardware. Mr X has, however, only paid the store a single amount for one product (comprising of both the goods and services). The store will charge Mr X output tax on the sale made regarding the single product as a whole. The contractor, after completing their work, will then charge the store for their services rendered and will be required to charge output tax on these services.

---

<sup>208</sup> The Taxpayer, Volume 65 Nos 7&8 page 121-126



It is therefore relatively easy to determine the VAT liability for the parties involved in the example transaction as they take place in a 'chain'. Mr X only transacts with the store and in turn the store (and not Mr X) transacts with the contractor.

Where transactions take place in a 'web', determining which party is providing which service is far more complex<sup>209</sup>. Consider the following adapted example<sup>210</sup>, (summarizing the key points of the transaction(s) in question):

D conducts a fast food delivery business. D contracts with local restaurants who for a fee payable to D list their menus in D's guide which is provided (by D) to houses in an area in which D operates. When a customer places an order with D, an employee of D communicates the order with the relevant restaurant. D then provides a driver with cash to pay for the meal and dispatches the driver to the restaurant. The drivers are not employed by D but are rather contracted by D and remunerated through a separate delivery fee that will appear on the invoice provided by D to the customer. The drivers are required to wear clothing branded by D and this clothing is meant to identify the drivers as acting on behalf of D. D charges the restaurant 20% commission on the order for its services in delivering the customer's order.

It is clear that in this example there is more than one transaction occurring simultaneously. It is also clear that the customer is transacting with more than one party simultaneously. In the case<sup>211</sup> counsel for SARS argued that the delivery fee (called 'drivers petrol money') was subject to VAT. The rationale SARS relied on was that D was in the business of delivering food to the people who ordered it and therefore the delivery charge is a service rendered by D and subject to VAT<sup>212</sup>. The taxpayer contended that the drivers were contractors and it was the drivers who conducted the service of delivering the food. Where D collected the delivery fee counsel for D contended that the drivers in question were

---

<sup>209</sup> The Taxpayer, Volume 65 Nos 7&8 page 121-126

<sup>210</sup> D v Commissioner for the South African Revenue Service (VAT 1390) [2016] ZAWCHC 72 (14 June 2016)

<sup>211</sup> D v Commissioner for the South African Revenue Service (VAT 1390) [2016] ZAWCHC 72

<sup>212</sup> D v Commissioner for the South African Revenue Service (VAT 1390) [2016] ZAWCHC 72 para 14



acting as agent. D further contended that their customers were the restaurants themselves and not the people placing an order through D<sup>213</sup>.

The court held that D was required to account for the output tax on the delivery charge. In his judgment BINNS-WARD J concluded that the economic substance of the transaction is what must be considered as a whole rather than the individual pieces. In substance, D was in the business of delivering food to callers. He further held that the drivers were acting on behalf of D (and not independent) as it was stipulated in the employment contract of the drivers that they will wear D's branded clothing at all times during delivery and they will notify the people who placed orders that they are the driver for D when they arrived with the food<sup>214</sup>. This judgment reinforces the principle that the courts will look to the economic substance of a transaction rather than its legal form.

Such 'transaction webs' exist in all sectors and may complicate matters even further when involving both taxable and exempt supplies. Take for instance the sale of a motor car that includes a 5 year service plan. The revenue from the sale of the motor vehicle consists of both sales of goods and rendering of services. There is also an aspect of finance involved, as the rendering of the services will take place at a future date but the price is locked in on the purchase of the motor vehicle. In effect the sale of this one item combines at least three types of revenue with regard to the motor dealer:

- The sale of the motor vehicle which is a standard rate supply for a motor vehicle dealer. This would be subject to VAT.
- The sale of future motor vehicle services (and parts) at a present dated price. This transaction would involve the discounting of the services at an appropriate interest rate (and could be far more complicated as the dealer may need to predict the

---

<sup>213</sup> D v Commissioner for the South African Revenue Service (VAT 1390) [2016] ZAWCHC 72 para 12-13

<sup>214</sup> D v Commissioner for the South African Revenue Service (VAT 1390) [2016] ZAWCHC 72 para 31



cost of the parts and probability of the wear and tear of those parts) to determine its present value.

- The service of the motor vehicle (when carried out) which would be a standard rate supply but has been paid for in advance and at a fixed price.

Here normally VAT is levied on the transaction price (inclusive of the service plan) and not separated into its parts. The seller of the vehicle is supplying both standard-rated and exempt supplies (the vehicle and the future contract for services). If the services contracts constitute more than 5% of the turnover, then the Input VAT claimable should be apportioned (see Chapter 4- Input Tax).

It is submitted that in order to ascertain the effects of VAT on these transactions, one must consider the economic substance of the agreements. It is clear that the customer is buying both a service contract and the motor vehicle. Both supplies are taxable and the determination of the VAT effect is straight forward. With respect to the time value of money on the future services, the dealership may assume this immaterial pay output tax on the entire amount up front. In substance however, the dealership has 'sold forward' the annual services of the motor car. The dealership should, therefore, take into account the value of the forward contract and apply this to its calculation for input tax to determine if it is over the 5% threshold. These principles will be applied to complex financial arrangements in the following chapter (Chapter 6 – Complex Financial Arrangements).





## Chapter 6 - Complex Financial Arrangements

The financial system is arguably the greatest invention of mankind. The system is a melting pot of regulations and laws that have developed over time providing services to individuals and businesses to exchange currency, safely store their money, access funds from anywhere in the world, trade securities and many others. Most of the financial systems we know today have been built on regulations implemented as a result of a financial crisis.

The most recent crisis of 2008 has ushered in a new era of banking caution. Risk management is now at the forefront of the banking industry.

The advance of the financial services industry and the focus on risk management has resulted in innovative ways of providing borrowers with funding and at the same time compensating lenders appropriately with regard to the credit risk of borrowers. The result of this is complex transactions that financial institutions use to manage their risk with regards to clients, sectors and even sovereigns, while ensuring they are delivering an appropriate return to their shareholders.

This chapter will discuss complex financial arrangements that financial institutions may utilize when providing credit. It has been submitted above that various arrangements, in isolation, will either be exempt or subjected to VAT. The types of transactions considered in this chapter incorporate two or more of these arrangements creating uncertainty on the treatment of the transactions.

### Syndicated Loans

Loan syndication refers to a method used by banks to minimize the credit risk to a single client by 'selling' the debt to other banks with appetite for it. Through syndication a bank



will be able to lend a large amount to a client but only retain a fraction of this on its balance sheet. This often takes place where there is credit arbitrage in the market.

The following example is typical:

Bank A approaches Government A with a debt package. The package consists of a loan to the government secured by a guarantee from the Ministry of Finance of the sovereign. The country has an A+ credit rating. The terms of the loan are that bank A will advance US\$500 million to the government which is payable semi-annually for 10 years. Interest of 3% above 6m US LIBOR will be payable Bi Annually, along with capital of the loan.

Bank A will retain 5% of this debt on its balance sheet and sell the remaining 95% to other banks with an appetite for A+ credit at 2.8% above 6m US LIBOR. Bank A will administer the loan in its entirety.

The example above shows how a bank will make use of credit arbitrage. The bank originates a US\$500 million loan at 3.0% and then 'sells' 95% of the loan to other banks for an interest rate of 2.8%. The bank therefore retains an asset of only US\$25 million at 3% as well as 0.2% (the difference between 3% and 2.8%) on US\$475 million (this is colloquially known as a 'skim'). This means the bank now has an effective interest rate of 6.8% on the US\$25 million retained. The issue now arises: is the 0.2% 'skim' subject to VAT.

Generally tax is levied on the legal form of a transaction. The tax treatment will therefore be determined by the agreements between the parties to the transaction. In order to examine the tax treatment of this transaction, the transaction must be dis-assembled into its individual parts in accordance with section 8(15)<sup>215</sup>. One must be cautious of this approach if the agreements do not reflect the economic substance of the arrangement. The courts will look to the economic substance of the arrangement to assist the VAT

---

<sup>215</sup> of the Value-Added Tax Act No. 89 of 1991

consequences as discussed above (see VAT in a Web of Transactions). For the purposes of this discussion it is assumed that the agreements reflect the economic substance of the arrangements:

The loan from the bank to the client:

The loan from the bank to the client would consist of a standard loan agreement whereby the bank would advance the funds to the borrower and in return for the right to use the funds the borrower will pay the bank interest. This transaction would be an exempt financial service in accordance with section 2(1)(f) and section 12(a)<sup>216</sup>. No VAT is levied on this part of the transaction.

The sale of the debtor at a premium to another bank:

In order for the bank to reduce its exposure to the borrower, the bank enters into an agreement with another bank. The agreement allows for the bank to dispose of its right to a portion of the loan to another bank at a lower interest rate than the bank is charging the client. The disposal agreement is such that it results in the credit risk shifting from the seller to the buyer of the debt. This is the disposal of a debt security. This is also exempt in accordance with section 2(1)(f) and section 12(a)<sup>217</sup>.

The difference in the interest rates

The origination bank is now left with profitable margin difference between the two debts. This is a result of credit arbitrage and other factors.

The transaction is normally implemented in one of two ways. A single loan agreement is drafted that covers two facilities, for discussion sake, facility A and Facility B. Facility A would be the portion 95% that will be sold to the external banks. Facility B would be the 5% retained by the originating bank. In this case the bank will enter into a separate

---

<sup>216</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>217</sup> of the Value-Added Tax Act No. 89 of 1991



arrangement with the external banks. The agreement will provide for cession of the originating bank's rights to the repayment of the capital of the loan as well as any security thereon. This sale will however be made at a different rate to the original loan. In essence the originating bank is borrowing money from the external banks at a lower interest rate than that which it is charging the client.

The reason (amongst others) for the buyer banks to purchase the credit below the rate advanced by the selling bank would be the compensation for the selling bank's obtaining the client and administering the facility for the duration of the loan.

In summary, the agreements only consist of loans between the originating bank and external banks. These loans will meet the definition of a financial service in accordance with section 2 of the VAT act. These agreements reflect the true nature of the transaction as the originating bank has, effectively, entered into a lending arrangement with the syndicated bank. This would also be true if both loans form part of the same facility. The credit arbitrage will result in an increase in the interest rate of the loan portion on book i.e. the US\$25m is now earning a rate of 6.8% as opposed to 3%. It is submitted that this would fall within the scope of Section 2(1) of the VAT act and therefore is exempt from VAT.

The second way such a transaction could be implemented is by way of two or more loan agreements with the client. This would result in the client receiving the full sum in the form of smaller loans as opposed to different facilities of the same loan. A deal such as this would typically be seen in a project finance transaction where Credit Insurance granted by an Export Credit Agency has been used. Such insurance will only cover a portion of the loan (normally up to 95% political risk and 85% commercial risk). The uncovered portion cannot be hedged, sold or reinsured as the insurer requires the originating bank



to be exposed to the credit risk of the client in order to rely on the banks credit vetting ('skin in the game'<sup>218</sup>).

Where an originating bank disposed of all its rights to 95% of the debt but retains the obligation of carrying out the administration of the loan the treatment of the remuneration for the credit arrangement becomes less clear. Activities of administering a loan will include monitoring of the client's financial situation, the payment of any credit insurance premiums, the status and value of the security, the calculation of interest and fees on the outstanding debt and others. These activities are done for both facilities by the originating bank as it is this bank with which the Export Credit Agency has the relationship.

The residual margin retained by the bank is inseparable from these services provided by the bank. The margin in this case could be seen as an ongoing fee for the administration of the loan by the originating bank (as it is not consideration for the provision of credit), on behalf of the external banks and a commercial justification for the credit arbitrage.

In this situation, it is submitted, there is not only a loan advanced by the bank to a client in accordance with facility A. The originating bank according to one agreement, acts as a lender yet according to another agreement, acts as a middle man providing value added services. It is submitted that in this circumstance, the margin is earned by the originating bank through the provision of administration services provided to the external banks and therefore has earned fee income even though this is not explicitly called a fee. Applying the principles as discussed in 'Chapter 5- VAT in a Web of Transactions' one must look through the legal form to the economic substance of the arrangement in order to ascertain the VAT consequences. It is submitted that considering substance of this arrangement output tax should be payable on the 'margin'.

---

<sup>218</sup> Colloquial term used to describe the originating entity retaining some of the credit or equity risk in the transaction.



## Commitment and Raising Fees

It is now common practice for financial service providers to charge fees when advancing money to a borrower. There are a broad range of fees that a bank can charge but these can be broadly categorised into ongoing fees and once off fees. The most common of these fees are the 'commitment fee' and the 'raising fee'.

A commitment fee is a fee charged by a bank to make funds available for a borrower. While the funds assigned to a client remain undrawn, the bank suffers an opportunity cost, as interest on the funds is only charged once, the funds are drawn but capital is held against a committed facility regardless of the balance outstanding. This fee is compensation for this opportunity cost. Typically the fee is expressed as a percentage of the available facility and is charged from signature date until full drawdown is made and is charged on the undrawn balance. Once the balance is fully drawn the fee ceases to accrue.

The fee is normally expressed as a clause in the loan agreement. The fee bears similar characteristics to interest charged on outstanding debts and is inseparable from the loan.

If the legal form of the agreement explicitly labels the commitment fee as such then it is submitted that it will fall within the scope of the proviso to section 2 of the VAT act and attract VAT. It would be unusual for this not to be referred to as a fee.

To ascertain the VAT effects on the charging of commitment fees, one would have to fully understand the economic substance of the transaction and the purpose of the compensation received by the financial institution. Consideration must be paid to the fact that the bank has not advanced any money, but merely set money aside which can then be drawn by the customer. It is therefore submitted that in substance there is no



outstanding debt and therefore cannot be any interest. The fee will therefore attract output tax (even if it is expressed as a rate of interest) as it falls within the proviso to section 2.<sup>219</sup>

Raising fees are once off fees charged by a lender in order to raise the funds the borrower requires. The fees are normally compensation for the consultant's time and technical knowledge applied to the transaction. Such fees are normally charged as a percentage of the monies to be lent and are payable up front, before the facility is made available.

It is clear that this fee charged is for the use of the consultant's professional services. The provision of the professional services is a taxable supply and the fee payable in this regard is subject to VAT.

## **Profit participations**

A profit participation refers to the right to participate in an entities profit. This could take the form of an ongoing share in the profits and or a share in the profits on the happening of a certain event (such as the disposal of an asset). Typically a bank will enter into such a transaction where the credit risk of a client outweighs the interest to be earned on the debt advanced to a client.

This type of agreement could also be effected where professional services are required but the client is unable to pay for them. Say for instance, a business is involved in a costly law suit, the acting legal team could agree to forgo their fee in exchange for a right to participate in a share of the profits of a company.

---

<sup>219</sup> of the Value-Added Tax Act No. 89 of 1991

If one were to test such an agreement against the definition of a derivative in terms of the VAT Act<sup>220</sup> (and therefore in terms of IAS 39<sup>221</sup>) it would meet this definition (it is submitted) and as a result be exempt:

The value of the future income will vary according to the result of the contract.

The result is to be decided by an independent party to the transaction (a court).

There is little initial investment as the law firm has paid no quantifiable assets for this right.

The amount will be settled in the future.

It is therefore reasonably arguable that this type of contract will meet the definition of a derivative and will constitute an exempt financial service as it meets the three-pronged test as contained in IAS 39<sup>222</sup>. In substance, however, the profit share is compensation for professional services rendered by the legal team. Were these to be settled in cash they would be subject to VAT in accordance with section 7 of the VAT Act.

It is submitted that in this case one must look to the nature of the original transaction i.e. the legal fees being settled by a right to receive future profits. Guidance for the treatment of this can be obtained from the test laid down in *Burmah Steamship Company Ltd v CIR*<sup>223</sup>. This test requires one to look at the nature of the loss being filled to determine if compensation for loss is capital or revenue. It is submitted that such a test could be used to determine if receipts in terms of an agreement are a derivative (financial service) or services rendered.

When applying this test, one would look through the agreement to its originating cause. The origin of the agreement was the client's inability to pay the legal fees required, which

---

<sup>220</sup>Section 2(2)(iiiA) of the Vat Act

<sup>221</sup> International Accounting Standard 39 – Financial Instruments: Recognitions and Measurement

<sup>222</sup> International Accounting Standard 39 – Financial Instruments: Recognitions and Measurement

<sup>223</sup> *Burmah Steamship Company Ltd v CIR* (1930) 16 TC 67, 1931 SC 156





if had been paid, would have been subject to VAT. In this case such a structure should attract VAT and will fall outside of the definition of financial services.

In some cases, a borrower's entity is only capable of sustaining debt at a certain interest rate. This interest rate is too low to adequately compensate the lender for the credit risk of the entity. Instead of turning the client away, the lender may choose to structure the loan in such a way that allows the lender to share in the profits of the company in addition to the interest of the debt advanced.

This share or 'participation' can be on going, at a point in time or both. Where the share is ongoing, it is common practice for this 'participation' to be calculated based on a financial metric of the company (normally Earnings before interest and tax 'EBIT' or Earnings before interest, tax, depreciation and amortization 'EBITDA'). Where it is at a point in time it is usually based on the happening of an event (such as the sale of a property after completion of the development thereof). The profit participation can be implemented as part of the loan agreement or as a separate agreement between the borrower and the lender.

It is submitted that the participation agreement could give rise to a derivative as:

The value of the agreement will vary along with the changes in the entities profit figures.

There is little initial investment from the financier to obtain the right to share in the profits.

The contract will be settled at a future date.

It is therefore submitted that such an agreement is a derivative. If the participation is given effect by the loan agreement then it is submitted that the debt is a hybrid debt instrument as it contains attributes of both equity and debt. The debt attribute is the loan to be advanced to the client. The equity attribute is the right to share in the profits of the company issuing such right. It is interesting to note that IFRS treats such a contract as an



embedded derivative in accordance with IAS 39, however, the accounting of a transaction should always be viewed with caution as the courts will not concern themselves with the book entries of a transaction.<sup>224</sup> Both the loan and the derivative will be exempt under section 2<sup>225</sup> and therefore attract no VAT.

An example of where the participation happens at a point in time is where the borrower grants the lender the right to share in the profits on sale of the company's assets. This could be the sale of a property (or other asset) after its development (which was funded by the lender) occurs.

This type of arrangement is contingent on the happening of a future event. The value of this right will vary depending on the happening of this future event and the contract requires little investment. This agreement will therefore meet the definition of a derivative under the test laid out by IAS 39.

It would seem that this creates the opportunity for tax avoidance, but this (it is submitted) is not the case. The sharing in the profits of the sale of the development can only happen once the property is sold. The sale transaction will (in most cases<sup>226</sup>) attract output tax in accordance with the definition of a supply<sup>227</sup>. The tax is therefore collected at the source of the funds and it is the after tax money that would be subject to the profit share arrangement.

The parties in the transaction above have clear roles. The financial service provider advances the money and receives the right to share in the profits of the company while the company uses these funds to realise the sale of the property. In practice it is not unusual for one or all of the parties to provide other services in addition to the above.

---

<sup>224</sup> See CIR v George Forest Timber Co Ltd 1924 AD 516 at 522 and 528; Pyott Ltd v CIR 1945 AD 128 at 135 and 136

<sup>225</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>226</sup> Unless it is the supply is an exempt supply e.g. the sale shares

<sup>227</sup>



Consider the following example:

Mr A approaches Bank B for funding of a development. Bank B considers Mr A's credit application and is comfortable with the risk. Bank B agrees to lend Mr A the money at an interest rate based on the credit risk of Mr A. Bank B is known to have a substantial share in a property development and trading company. Bank B (in addition to the loan) offers to provide any further funding and expertise required to Mr A (without delay) in return for a right to share in the profits (and not losses) on the sale of the development. Mr A agrees to grant Bank B such a right.

The example above is a profit participation that occurs on the happening of a future event. The profit participation would meet the definition of a derivative as Bank B has little upfront investment, the value of the agreement will vary in accordance with Mr A's performance regarding the development and sale of the property and the contract will be settled at a future date. Bank B is (on application of the act) in possession of a derivative which is exempt from VAT in accordance with (section 2(1)(k)<sup>228</sup>). It is submitted that this narrow approach is incorrect as it favours legal form over economic substance.

In substance, the right is only granted to Bank B because of its offer to provide Mr A with advice. It is accepted that the provision of professional services (such as advice) by a financial institution is subject to VAT. In economic substance, the compensation the Bank receives for providing advice to Mr A is the right to share in Mr A's profits and therefore such right should be subject to VAT. In accordance with the time of supply rules, VAT will be payable by Bank B on the earlier of invoice to Mr A or payment by Mr A.

A potential dilemma arises when determining what portion of the amount is taxable and the following submissions are made in this regard. It would be incorrect to assume that the full value of the consideration received is as a result of the professional services rendered by Bank B to Mr A, as doing so will attach a value of nil to the derivative. It would therefore be appropriate to apply section 10(3)<sup>229</sup> and calculate the output tax payable on

---

<sup>228</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>229</sup> of the Value-Added Tax Act No. 89 of 1991



the open market value of the advice given to Mr A. The remaining amount of consideration will be the value received in respect of the derivative that Bank B entered into with Mr A.

## **Sale or Repossession of Property as a Result of Default**

Lenders normally take property as security for loans advanced. In some cases the borrower is unable to repay the debt and the lender is forced to act on its security. This can take on various forms but typically the lender will do one of two things: force the borrower to sell the property and use the proceeds to settle the debts or assume ownership of the property as settlement of the debt.

### **Forced sale of property**

The VAT consequence on the sale of fixed property is depended on various factors. The VAT act exempts the sale of residential property from VAT in almost all circumstances. If the borrower is not a VAT vendor then the purchaser will be liable for the transfer duty.

By way of example, assume that the lender has transacted with a VAT registered entity making 100% taxable supplies and the property in question is a commercial property. As security for monies borrowed, the borrower registers a first mortgage bond over the commercial property. The borrower defaults on the debt and the lender is forced to execute on the bond. The lender forces sale of the property after following all legal procedure. The lender's debt is settled from the proceeds of the sale of the property and the balance is given to the borrower in default.

The seller (the borrower in default) will be required to account for output tax on the proceeds received for the property. The seller will then settle the debt with the bank consisting of interest and capital. The settlement of the debt will attract no VAT as it is the



transfer of money and therefore falls outside the scope of the act (as it is neither goods nor services).

## **Instalment Credit Sales and Repossessions**

The VAT Act contains specific rules for the installment sales. The VAT Act defines 'installment credit sale' as follows:

"instalment credit agreement"

means any agreement entered into on or after the commencement date whereby any goods consisting of corporeal movable goods or of any machinery or plant, whether movable or immovable—

(a) are supplied under a sale under which—

- (i) the goods are sold by the seller to the purchaser against payment by the purchaser to the seller of a stated or determinable sum of money at a stated or determinable future date or in whole or in part in instalments over a period in the future; and
- (ii) such sum of money includes finance charges stipulated in the agreement of sale; and
- (iii) the aggregate of the amounts payable by the purchaser to the seller under such agreement exceeds the cash value of the supply; and
- (iv)

(aa) the purchaser does not become the owner of those goods merely by virtue of the delivery to or the use, possession or enjoyment by him thereof; or

(bb) the seller is entitled to the return of those goods if the purchaser fails to comply with any term of that agreement; or

(b) are supplied under a lease under which—

- (i) the rent consists of a stated or determinable sum of money payable at a stated or determinable future date or periodically in whole or in part in instalments over a period in the future; and
- (ii) such sum of money includes finance charges, including any amount determined with reference to the time value of money, stipulated in the lease; and



- (iv) the aggregate of the amounts payable under such lease by the lessee to the lessor for the period of such lease (disregarding the right of any party thereto to terminate the lease before the end of such period) and any residual value of the leased goods on termination of the lease, as stipulated in the lease, exceeds the cash value of the supply; and
- (v) the lessee is entitled to the possession, use or enjoyment of those goods for a period of at least 12 months; and
  - (aa) the lessee accepts the full risk of destruction or loss of, or other disadvantage to, those goods and assumes all obligations of whatever nature arising in connection with the insurance, maintenance and repair of those goods while the agreement remains in force; or
  - (bb)
    - (A) the lessor accepts the full risk of destruction or loss of, or other disadvantage to those goods and assumes all obligations of whatever nature arising in connection with the insurance of those goods; and
    - (B) the lessee accepts the full risk of maintenance and repair of those goods and reimburses the lessor for the insurance of those goods, while the agreement remains in force;<sup>230</sup>

The definition characterises two types of Installment Credit Agreements, a 'sale' (or suspensive sale agreement) and a 'lease'. The definition sets the following criteria for:

A sale agreement:

- The goods are sold by a seller to a purchaser for payment by the purchaser to the seller for a stated or determinable sum of money, at a stated or determinable future date or in instalments over a period in the future
- Such sum of money includes finance charges stipulated in the agreement of sale

---

<sup>230</sup> Section 1 of the VAT Act

- The aggregate of the amounts payable by the purchaser to the seller under such agreement exceeds the cash value of the supply, meaning that the goods may not be supplied at a loss by the seller
- The purchaser does not become the owner of those goods merely by virtue of the delivery to or the use, possession or enjoyment by him thereof or the seller is entitled to the return of those goods if the purchaser fails to comply with any term of that agreement

A lease agreement:

- The rent consists of a stated or determinable sum of money payable at a stated or determinable future date or in instalments over a period in the future
- Such sum of money includes finance charges and mark-ups based on time-value of money principles as stipulated in the lease
- The aggregate of the amounts payable under such lease by the lessee to the lessor for the period of such lease and any residual value of the leased goods on termination of the lease, as stipulated in the lease, exceeds the cash value of the supply, meaning that the goods may not be supplied at a loss by the lessor
- The lessee is entitled to the possession, use or enjoyment of those goods for a period of at least 12 months
- The definition of a finance lease also includes the situation where:
  - the lessor accepts the full risk of destruction or loss of, or other disadvantage to those goods and assumes all obligations of whatever nature arising in connection with the insurance of those goods; and
  - the lessee accepts the full risk of maintenance and repair of those goods and reimburses the lessor for the insurance of those goods



Considering the above, it is submitted, the major difference between a suspensive sale and finance lease is with which person the risk of ownership lies. In terms of a suspensive sale the risk of ownership will pass to the purchaser on the date that the suspensive sale condition is complied with, whereas in terms of a finance lease the risk of ownership will pass to the lessee at the date that the lease agreement is concluded.

In the case of instalment credit agreements, the consideration in money for the supply is deemed to be its cash sale value. The VAT based on the cash cost will be claimed in total as input tax at the earlier of delivery or payment date by the purchaser or lessee, whilst the seller or lessor raises output tax in total on the cash cost of the goods at that time. The cash cost excludes interest, as interest is exempt from VAT because it constitutes consideration for the supply of a financial service.<sup>231</sup>

In the case of instalment credit agreements, the time of supply is the earlier of the time of delivery of the goods or the time any payment is received. This rule does not apply when the supply is made under a credit agreement in terms of which the buyer has a right to return the goods within a certain time.<sup>232</sup>

Where any amount of a supply of goods in terms of an instalment credit agreement has become irrecoverable, there could be an additional amount of input tax for the supplier. The adjustment of the amount of input tax should be restricted to the tax content of the amount that has become irrecoverable in respect of the cash value of such supply. The

---

<sup>231</sup> Section 10(6) of the VAT Act

<sup>232</sup> Section 9(3)(c) of the VAT Act





total amount due should be apportioned to determine the outstanding amount of the cash value (first proviso (i) to section 22(1))<sup>233</sup>.

No amount of input tax could be claimed if there was an amount irrecoverable in terms of an instalment credit agreement and the vendor repossessed the goods or is obliged to take possession of the goods (second proviso (i) to section 22(1 ))<sup>234</sup>.

This is on the basis that where the goods are repossessed or surrendered, the debtor is deemed to make a supply to the vendor (original supplier) in terms of section 8(10)<sup>235</sup> for a consideration in money equal to the balance of the cash value of the goods (section 10(16)) and the vendor is entitled to claim an input tax deduction at such time when the deemed supply is made to it (s 9(8)) in terms of the normal provisions (section 16(3)(a)(i)<sup>236</sup>).

.

## Credit Guarantee

A credit guarantee is a promise made by the guarantor that in the case where the guarantee is unable to discharge his obligation as agreed, the guarantor steps into the shoes of the guarantee and performs his obligations.

In some cases an entity may not have a strong enough balance sheet or credit rating to execute a transaction. In this case the entity may approach a financial services provider, with the appropriate risk appetite, for a credit guarantee. The financial services provider in this case may grant the guarantee in return for 'interest' as if it were funds advanced.

---

<sup>233</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>234</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>235</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>236</sup> of the Value-Added Tax Act No. 89 of 1991



In the case that the guarantee is not called upon, the guarantor has not advanced any funds but has at the end of the contract received payment as if funds were granted. The guarantor has therefore only been compensated for the credit risk incurred and not for the advance of the funds. It is therefore submitted that this type of arrangement falls outside the scope of section 2 of the VAT Act and is not a financial service as defined. The profits earned on the guarantee are therefore a service and are a taxable supply.

## **Credit Insurance**

Countries target exports as a way of growing their economies. In an effort to stimulate exports of items from the countries some have commissioned government owned credit insurance corporations known as 'Export Credit Agencies'. These corporations grant credit insurance for political and commercial risk to pre-authorized financial institutions. The export credit agency of South Africa is known as Export Credit Insurance Corporation ('ECIC').

ECIC will insure a lender for monies advanced to the buyer of the goods of a South African manufacturer (subject to various requirements). The insurance in effect mitigates the credit risk of the buyer therefor allowing the lender to take on South African government risk. For this cover these agencies charge an insurance premium. This premium is subject to VAT.

If the borrower defaults on its obligations and the lender is forced to claim on its insurance contract, the insurer may pay a lump-sum in full settlement of the loan, or service the loan as if it were the lender. This creates a difficulty for VAT.



If the loan is settled in a lump-sum, the full premium will be subject to VAT in accordance with the definition of a supply in section 1<sup>237</sup>.

It is submitted that the ongoing payments to the lender are also subject to VAT as they are not compensation for monies borrowed as defined in section 2<sup>238</sup>.

It is clear that a lender may suffer a short fall of 14% as the monies advanced were subject to VAT at 0% in accordance with section 11(i)<sup>239</sup> (foreign lending is zero rated) but are now taxed at 14%. Lenders can protect themselves by agreeing with the insurer that the payouts must include an additional 14% over and above the installment.

This issue is especially true where a local lender advances money to an exporter but takes out foreign credit insurance. In this case it is submitted that on default, the claims will be subject to output tax calculated on the reverse charge basis as discussed above.

---

<sup>237</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>238</sup> of the Value-Added Tax Act No. 89 of 1991

<sup>239</sup> of the Value-Added Tax Act No. 89 of 1991



## Chapter 7 – 21<sup>st</sup> Century Financial Services

### Crowd Funding

Crowd funding is a popular way for start-up companies to fund innovative products or services and is extremely popular overseas Technology Sector. The terms of the funding arrangements vary and there are four main types: debt funding, equity funding, donation funding, and rewarded funding.

Recently the European Union requested its Value-Added tax committee to compile a report on the application of VAT to crowd funding.<sup>240</sup> The main issues highlighted by the report are the VAT implications for the four types of funding and on any fees or commissions charged by the crowdfunding platforms.

The types of crowdfunding and their VAT consequences will be discussed below:

#### Donations to a Project

Donations are neither a supply of goods nor services. It is merely the transfer of money. It is submitted that donation funding falls out of the scope of the VAT act and is therefore not subject to VAT.

#### Equity Funding

Equity funding of a project is similar to the subscription to shares in a company. The funder gives money in return for a right to participate in the company's shares, profits or both. As discussed above, shares and derivatives (rights to profit) are exempt from VAT in terms of section 2 of the VAT act. It is submitted that these transactions will not be subject to VAT.

---

<sup>240</sup> Value Added Tax Committee (Article 398 Of Directive 2006/112/Ec) Working Paper No 836



## Debt Funding

Debt crowd funding is similar to equity funding, where an investor expects a return for his/her money. Debt transactions are as discussed under Direct Loan Services (page 30) exempt from VAT and it is therefore submitted that debt crowdfunding transactions will also be exempt from VAT.

## Reward Funding

Reward funding is where the requester of funds offers a reward to the funder in return for the funds. This reward can range from something as simple as a souvenir with little or no value, to a full product to be produced.

In order to determine if the funds received are for the goods to be delivered or for some other reason (a donation), a link must be established between the products transferred and the funds received.

If the products transferred are insignificant in comparison to the funds received the transaction may be a donation:

Mr X pledges R5000 towards a start up company wishing to build a high tech water filter. The company then sends Mr X a sticker with the logo and slogan of the company as a souvenir.

In this case the sticker is of insignificant value and there is no obligation for the company to deliver any goods or services to Mr X. It is submitted that this is a donation and will therefore fall out of the scope of the VAT act.



Pre-selling of goods is more complex. Ordinarily the presale of goods would attract VAT in accordance with the principles discussed in Chapters 1, 2 and 3. The issue with crowd funding is the timeframe of when the products will actually be provided or if they ever will be. It is submitted that regardless of how long the production takes or if the goods will be delivered, the seller of the goods will be required to pay output tax on the presales cash flow (on the earlier of invoice or payment in accordance with section 9(1) of the VAT Act). The receiver will then be entitled to claim input VAT on the same basis if the buyer is a vendor and acquires the goods for the purpose of making taxable supplies. If the goods are not delivered, and the prepayment is returned, the seller of the goods will be entitled to claim the refund as input tax and the buyer of the goods must levy output tax on the refund.

Crowd funding platforms charge fees and commissions for the use of their platforms and for successful transactions. It is submitted that the provision of such services comprise taxable supplies and the fees and commissions charged as consideration for their use are subject to VAT.

## **Peer-to-Peer Lending**

Peer-to-peer lending is the practice of lending money to individuals or businesses through online services that match lenders directly with borrowers. Such companies typically operate online or through mobile applications. This allows these companies to run with very little overheads. The reduced overheads allow the lender to achieve a higher return at a lower interest rate than they would obtain at a financial institution. These loans are normally unsecured loans. The acquisition of finance is normally done through a reverse auction model where lenders compete for the business by offering the lowest interest rate.

An example of a transaction is as follows:



Mr X is looking for a personal short term loan of R1000.00. Mr X logs onto a popular peer-to-peer lending website and places a request for financing. Mr Y offers to finance Mr X for a month at a rate of 3.5% per month and Mr X accepts the offer. The website charges both Mr X and Mr Y a small fee of R10.00 for the use of its platform.

The above example (assuming all parties are based in South Africa) is similar to a typical lending transaction. The loan and interest thereon from Mr Y to Mr X is exempt from VAT in accordance with section 2(1)(f) of the VAT Act. The fee charged by the website is subject to VAT as it is not an exempt financial service in accordance with the proviso to the definition of financial services.

Complexities arise where one or all of the parties are not residents of South Africa, present in South Africa or are not registered for South African VAT. In such cases a portion of the transaction may be zero rated and a portion exempt, only one side of the transaction may be South African sourced and therefor only one part of the fee should be subject to VAT at the standard rate.

If the lender is South African and a vendor, and lends to a foreigner, then the loan will be zero rated as discussed under loan intermediation. The fee charged by the provider to the lender will be allowed as input (to the extent that the lender makes taxable supplies). The foreigner's fee is not of a South African source and is therefore not subjected to VAT in South Africa, but the borrower may be liable to account for VAT on the fee as imported services.

If the lending platform is in South Africa, all fees generated by the platform will be subject to VAT in accordance with the proviso to section 2<sup>241</sup>.

---

<sup>241</sup> of the Value-Added Tax Act No. 89 of 1991

## Cryptocurrency

A cryptocurrency is a medium of exchange using cryptography to secure the transactions and to control the creation of additional units of the currency. Cryptocurrencies exist only digitally and are decentralised (not governed by a reserve bank) and use a 'block chain' transaction database. Bitcoin became the first cryptocurrency (released in 2009) and is widely traded today. The 'block-chain' database is essentially a highly secure ledger that records transactions. This ledger allows users to connect to it to process transactions, verify transactions and update the transactions.

Bitcoin can be purchased through the internet and is stored in a digital 'wallet' and can then be used to transact with vendors that accept Bitcoin (as with any other currency).

As discussed above [reference] the VAT Act exempts the exchange of currency. The VAT Act also provides the following definition:

‘ “**currency**” means any banknote or other currency of any country, other than when used as a collector’s piece, investment article, item of numismatic interest, or otherwise than as a medium of exchange;’

It is clear that the definition only includes ‘banknotes or other currency of any country’. If this definition were strictly applied to the purchase or sale of Bitcoin (i.e. exchanging Rand for Bitcoin) then such an exchange would not fall into the scope of this definition.

Such a transaction should then be tested against the definition of a supply of goods or services.

“‘goods”

means corporeal movable things, fixed property any real right in any such thing or fixed property, and electricity, but excluding—

(a) money;





- (b) any right under a mortgage bond or pledge of any such thing or fixed property; and  
any stamp, form or card which has a money value and has been sold or issued by the State for the payment of any tax or duty levied under any Act of Parliament, except when subsequent to its original sale or issue it is disposed of or imported as a collector's piece or investment article;'
- (c)

The VAT act defines money as follows:

"money"

means—

- (a) coins (other than coins made wholly or mainly from a precious metal other than silver) which the South African Reserve Bank has issued in the Republic in accordance with the provisions of section 14 of the South African Reserve Bank Act, 1989 (Act No. 90 of 1989), or which remain in circulation as contemplated in the proviso to subsection (1) of that section, and any paper currency which under the said Act is a legal tender;
- (b)
  - (i) any coin (other than a coin made wholly or mainly from a precious metal) or paper currency of any country other than the Republic which is used or circulated or is intended for use or circulation as currency;
  - (ii) any bill of exchange, promissory note, bank draft, postal order or money order,  
  
except when disposed of or imported as a collector's piece, investment article or item of numismatic interest;'

Cryptocurrency by nature does not belong to any country. It is therefore submitted that it would not meet the definition of 'money' and therefore be considered a 'good' in accordance with section 1 of the VAT Act.

Section 10 (18, 19) deal with the supply of a voucher with monetary value:

- (18) 'Where a right to receive goods or services to the extent of a monetary value stated on any token, voucher or stamp (other than a postage stamp as defined in section 1 of the Postal Services Act, 1998, and any token, voucher or stamp contemplated in subsection (19)) is granted for a consideration in money, the supply of such token, voucher or stamp is disregarded for the purposes of this Act, except to the extent (if any) that such consideration exceeds such monetary value.



- (19) Where any token, voucher or stamp (other than a postage stamp as defined in section 1 of the Postal Services Act, 1998) is issued for a consideration in money and the holder thereof is entitled on the surrender thereof to receive goods or services specified on such token, voucher or stamp or which by usage or arrangement entitles the holder to specified goods or services, without any further charge, the value of the supply of the goods or services made upon the surrender of such token, voucher or stamp is regarded as nil.'

These subsections require the VAT to be disregarded on the supply of a voucher. The voucher is required to state the monetary value on the face of the voucher. This is problematic as Cryptocurrencies exist only digitally and have a value established by a free market. However, SARS in the draft interpretation note on the Value Added Tax Treatment of Vouchers<sup>242</sup>, states that a digital record of the monetary value of a voucher will be sufficient. Cryptocurrencies use 'block-chain' to keep a digital record of all transactions and it is submitted that this will suffice as a record of money.

In a recent case the European Court of Justice ruled that the purchase and sale of Bitcoin is not subject to VAT:

'52 In the case in the main proceedings, it is common ground that the 'bitcoin' virtual currency has no other purpose than to be a means of payment and that it is accepted for that purpose by certain operators.

53 Consequently, it must be held that Article 135(1)(e) of the VAT Directive also covers the supply of services such as those at issue in the main proceedings, which consist of the exchange of traditional currencies for units of the 'bitcoin' virtual currency and vice versa, performed in return for payment of a sum equal to the difference between, on the one hand, the price paid by the operator to purchase the currency and, on the other hand, the price at which he sells that currency to his clients.'<sup>243</sup>

---

<sup>242</sup> <http://www.sars.gov.za/AllDocs/LegalDoclib/Drafts/LAPD-LPrep-Draft-2014-19%20-%20Draft%20IN%20VAT%20Treatment%20of%20Vouchers.pdf>

<sup>243</sup> ECLI:EU:C:2015:718 para 52-53  
(<http://curia.europa.eu/juris/document/document.jsf?text=&docid=170305&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=535347>)



It is therefore submitted the South African courts will be persuaded by this judgment and that the sale and purchase of Bitcoin (and other Cryptocurrencies) will not be subject to VAT. but rather the use of Bitcoin to acquire goods or services ( in practice, exchange controls limit the use of currencies other than Rand in South Africa and it is unlikely for a local vendor to accept Bitcoin.)



## Conclusion

The rapid evolution of information technology has resulted in the formation of a global economy. At the touch of a button, clients can move funds to and from virtually anywhere in the world. Financial service providers now compete globally for market share and clients. Fierce competition in the market and investors insatiable need for higher returns has resulted in the creation of various financial arrangements which seek to exploit certain aspects of the financial system. Increased regulation of the industry has paved the way for institutions to create complex structures in order to circumvent such regulations or exploit their deficiencies and deliver enhanced returns to their shareholders.

Applying a (for the most part) rules based VAT, that has largely remained unchanged, to this new environment is as fascinating as it is difficult. This report, through its various chapters seeks to provide basic submissions on the effects and treatment of the VAT on some of the more common financial transactions and a select few complex transactions.

Chapter 1 – The Exempting of Financial Services, puts forward the current legal framework in which financial services are evaluated with respect to VAT. It highlights the basic operations of the VAT Act with regard to financial services and looks to the reasons provided by VATCOM for the exemption of financial services (noting that while in theory VAT could be applied to financial services, they were exempt due to practical limitations). The idea of taxable fee based financial services versus non fee based exempt financial services is introduced and sets the backdrop on which the following chapters will build.

Chapter 2- The Meaning of the Word Fee, proposes an interpretation of the word ‘fee’ and submits that this is crucial in determining if a financial service is subject to VAT. The word ‘fee’ is not defined in the VAT Act and the discussion seeks to attach meaning to the word by following the South African statutory interpretation approach. The submission is made that there are three key characteristics of a fee transaction, the first of which would require the payment of money from one party to another in accordance with an



agreement between the two parties. The second is that money must be transferred in return for 'something' and the third is that 'something' must be identifiable as a service rendered to the payer.

Chapter 3 – Common Financial Services Provided examines commonly encountered financial services and the VAT consequences thereof. The chapter describes the appropriate sections of the VAT Act and concludes on each service discussed.

Chapter 4 - Input Tax introduces the concept of input tax within the realm of financial services. It examines the requirements of vendors with regard to calculating their input tax entitlement. Input tax relating specifically to financial service providers is also discussed.

Chapter 5- VAT in a Web of Transitions, deals with a recent court decision regarding VAT within a 'web of transactions'. Financial institutions often bundle multiple services into one transaction. Often such services are a mix of taxable and exempt supplies. The chapter highlights the court's approach to the application of VAT with respect to a 'web of transactions' and the need to determine the economic substance of the arrangement rather than strict application of the VAT Act to the legal form.

Chapter 6- Complex Financial Arrangements, tests some of the less common financial arrangements against the provisions of the VAT Act and relevant law. These arrangements are uncommon and often only occur between financial service providers or with selected clients. The chapter selects limited (and simplified) examples to illustrate the types of transactions and their basic operation. The chapter makes submissions based on these simplified examples. It is submitted that through the analysis of these transactions a general approach to complex financial arrangements is established; the economic substance of the arrangement must be determined before application of the VAT Act to the legal form. Application of the VAT Act to the legal form should only be



done (it is submitted) once it has been established that the legal form represents the economic substance.

Chapter 7- 21<sup>st</sup> Century Financial Services, deals with ‘twenty-first century’ ( or ‘high-tech’) financial instruments but limits its scope to Crowd Funding, Peer-to-Peer lending and Cryptocurrency. The recent introduction of these offerings to the financial service industry has forced the discussion of these instruments in this report to be largely academic. In order to determine the true VAT consequence of these instruments one requires a peculiar knowledge of technical operations of each of them. For the purposes of this report a simplified, general approach has been applied to each of these instruments as well as submissions with regard to the VAT effects these instruments will attract within these simplified examples.

#### Limitations and areas for future research

This report is limited to an analysis of the financial services most commonly encountered. The report makes important submissions regarding the treatment VAT on the various financial services within its discussion scope. The report does not examine the operations of the various instruments with regard to income tax or other fiscal legislation nor does the report provide an in-depth analysis and/or description of each of the services discussed.

Future research into the interaction between the income tax and VAT effects of the various instruments will prove a valuable addition to this research. Analysis of the VAT effects on extremely complex financial arrangements such as Credit Default Swaps, synthetic currency loans, high-frequency trading and many others is of great importance to the Fiscus and the financial sector.



After consideration of the submissions put forward by this report and the evidence provided in support of these submissions it is clear that there is no 'one size fits all' application of the financial services provision of the VAT Act to financial transactions. The judgement of Binns- Ward J in VAT Case 1390 is a welcomed interpretation method when dealing with VAT on financial instruments. It is respectfully submitted that even when applying this method, the look-through to the economic substance of an arrangement is not always as clear as it seems as. In some extreme cases, even the contracting parties may not fully understand the economic implications of the transactions they are party to (and such a lack of understanding is what fueled the financial crises). Considering the intricacies of the services discussed in this report and the pace at which new structures are developed, the following extract is a parting thought:

'The line between investing and gambling is artificial and thin. The soundest investment has the defining trait of a bet (you losing all of your money in the hopes of making a bit more), and the wildest speculation has the salient characteristic of an investment (you might get your money back with interest).'<sup>244</sup>

---

<sup>244</sup> The Big Short - Michael Lewis



## Annexure A - Synopsis of South African Statutory Interpretation.

The welcomed judgment of *Natal Joint Municipal Pension Fund v Endumeni Municipality* dealt in with statutory interpretation in detail. It is therefore submitted that case law prior to this judgment regarding statutory interpretation should be viewed with caution. Prior to this judgement South African law accepted (used with caution) two methods of interpretation: the text-based approach and the text-in-context approach. These two approaches will be discussed in brief to serve as background to the judgment.

### The text based approach:

This approach assumes as its primary rule of interpretation that, if the meaning of the text is clear (the plain meaning), it should be applied, and, indeed, equated with the legislature's intention. Authority for this can be found in *Principal Immigration Officer v Hawabu* 1936 AD 26. The court may only deviate from the 'plain meaning' of the words if the text is ambiguous, vague or misleading, or if a strict literal interpretation would result in absurd results<sup>245</sup>. This is also known as the 'golden rule' of interpretation. Then the court will turn to the so-called 'secondary aids' to interpretation to find the intention of the legislature. 'Secondary aids' were considered to be text contained in the statute in question (such as ,*inter alia*, the long or short title and the headings or chapters of sections) or other official statutes and translations of the statute in question in other official languages. Simarlarily the courts would only turn to 'tertiary aids' if the 'secondary aids'

---

<sup>245</sup> Innes CJ in *Venter v Rex* 1907 TS 910:

'when to give the plain words of the statute their ordinary meaning would lead to absurdity so glaring that it could never have been contemplated by the legislature or where it would lead to a result contrary to the intention of the legislature, as shown by the ontext or by such other considerations as the court is justified in taking into account, the court may depart from the ordinary effect of the words to the extent necessary to remove the absurdity and to give effect to the true intention of the legislature.'





proved insufficient in ascertaining the meaning of the text in question. 'Tertiary aids' were considered to be concepts such as the common-law presumptions.<sup>246</sup>

This approach was widely adopted from English law which followed a predominantly text based approach. C Botha cites the following general reasons for English law following this approach:

'Misconceptions about the doctrines of the separation of powers (the trias politica doctrine) and sovereignty of Parliament resulted in acceptance of the idea that the court's function should be limited to the interpretation and application of the will of the legislature, as recorded in the text of the particular legislation. In other words, the will of the legislature is to be found in the words of the legislation.

The doctrine of legal positivism influenced the literal approach in England. The positivist idea is based on the validity of the decree (command): that which is decreed by the state is law, and consequently the essence of the law is to be found in the command or decree. The role of the court is limited to the analysis of the law as it is and to find the intention of the legislature, and should not be a speculation about what the law ought to be. A strict distinction is made between 'black-letter law' and morality, because value judgements by the courts would lead to the justiciability of policy issues.

England has a common-law tradition, in which the courts have traditionally played a very creative role in regard to common-law principles. Legislation was viewed as the exception to the rule, altering the traditional common law as little as possible.

English legislation was drafted to be as precise and as detailed as possible, for the sake of legal certainty and to cover any number of possible future cases. The well-known maxim that the legislature has prescribed everything it wishes to prescribe is derived from this approach.'<sup>247</sup>

Botha further submits that Chief Justice De Villiers in *De Villiers v Cape Divisional Council 1875 Buch 50*, decided that legislation that had been adopted after the British had taken over the Cape should be interpreted in accordance with the English rules of statutory interpretation.

---

<sup>246</sup> Statutory Interpretation- an introduction for students 5th edition – Christo Botha

<sup>247</sup> Statutory Interpretation- an introduction for students 5<sup>th</sup> edition – Christo Botha



The following dictum of Stratford JA in *Bhyat v Commissioner for Immigration*<sup>248</sup> is one of the classic authorities of the orthodox text-based method of interpretation employed by South African courts:

'The cardinal rule of construction of a statute is to endeavour to arrive at the intention of the lawgiver from the language employed in the enactment ...in construing a provision of an Act of Parliament the plain meaning of its language must be adopted unless it leads to some absurdity, inconsistency, hardship or anomaly which from a consideration of the enactment as a whole a court of law is satisfied the Legislature could not have intended.'

There are many criticisms of the text based approach. The following submissions are made in this regard. The approach assumes that common law presumptions will only apply if the text is ambiguous. There is an assumption that the text is the primary source of meaning and from where the intention of the legislature can be obtained<sup>249</sup> and therefore the meaning of the text is dependent on how clear the language is to the court interpreting it. This doctrine leaves little room for judicial law making as it assumes the statutes are the final word and the courts are merely machines of interpretation.

## The text in context approach

This approach assumes the purpose or object of the legislation is the prevailing factor in interpretation. The approach introduces the 'mischief rule'. The mischief rule was introduced by Lord Coke in *Heydon's Case (1584) 3 Co Rep 7a (76 ER 637)*. The rule poses four questions:

What was the existing law before the legislation in question was adopted?

Which problem was not adequately addressed by the existing law?

---

<sup>248</sup> 1932 AD 125 129

<sup>249</sup> R v Hidick-Smith 1924 TPD 68 81



What remedy is proposed by the new legislation?

What is the true reason for the remedy?

The rule attempts to examine the circumstances that lead to the adoption of the legislation in question. The mischief rule acknowledges the application of external aids: the common law prior to the enactment of the legislation, defects in the law not provided for by the common law, whatever new remedies (solutions) the legislature provides, and the true reason for the remedies. The search for the purpose of legislation requires a purpose-orientated approach which recognises the contextual framework of the legislation right from the outset, and not only in cases where a literal, text-based approach has failed. The text-in-context approach provides a balance between grammatical and overall contextual meaning. The interpretation process cannot be complete until the object and scope of the legislation (ie its contextual environment) are taken into account. In this way the flexibilities and peculiarities of language, and all the intra-textual and extra-textual factors, are accommodated in the continuing time-frame within which legislation operates.

According to the text-in-context approach, the judiciary has inherent law-making discretion during statutory interpretation; although an exception to the rule, the courts may modify or adapt the initial meaning of the text to harmonise it with the purpose of the legislation. The role of the courts is therefore far more flexible, and is not limited to mere textual analysis and mechanical application of the legislation. However, this discretion is qualified by the prerequisite that modification of the meaning of the text is possible (and admissible) only if and when the scope and purpose of the legislation is clear and supports such a modification. Such a law-making function of the judiciary is not an infringement of the legislature's legislative function, but merely a logical extension of the powers of the court during the interpretation and application of the relevant legislation in each practical instance. For the text-in-context approach the use of the common-law presumptions, as



well as all the various aids to interpretation, are very important tools in the quest for the scope and purpose of legislation.

The constitution (*lex fundamentalis* )

Although most academics in South Africa before 1994 propagated a text-in-context (purposive) method of statutory interpretation that recognised the vital importance of the legislative context, few of the courts actually adopted a less formalistic approach to interpretation. However, since 27 April 1994 the (largely academic) debate about a text-based approach versus a text-in-context approach to statutory interpretation has become irrelevant. Since both the interim Constitution (section 35(3)) and the 1996 Constitution (section 39(2)) included an express and mandatory interpretation provision, statutory interpretation (like all law in South Africa) now has to be conducted within the value-laden framework of the supreme Constitution which is the highest law of the land. Apart from the constitutional values, the interpretation of statutes was transformed by six provisions of the Constitution<sup>250</sup>, in particular: section 1 (the foundational provision); section 2 (supremacy of the Constitution); section 7 (the obligation clause); section 8 (the application clause); section 36 (the limitation clause) and section 39 (the interpretation clause).

## **Constitutional supremacy**

Section 1 of the Constitution is the foundational clause:

The Republic of South Africa is one, sovereign, democratic state founded on the following values:

- (a) Human dignity, the achievement of equality and the advancement of human rights and freedoms.

---

<sup>250</sup> Constitution of the Republic of South Africa, 1996



- (b) Non-racialism and non-sexism.
- (c) Supremacy of the constitution and the rule of law.
- (d) Universal adult suffrage, a national common voters roll, regular elections and a multi-party system of democratic government, to ensure accountability, responsiveness and openness.

## Section 2 of the Constitution

This Constitution is the supreme law of the Republic; law or conduct inconsistent with it is invalid, and the obligations imposed by it must be fulfilled.

Section 2 must be read with section 7 of the Constitution, which states that the Bill of Rights is the cornerstone of the South African democracy, and that the state must respect, protect, promote and fulfil the rights in the Bill of Rights, section 8(1), which states that the Bill of Rights applies to all law, and binds the legislature, the executive, the judiciary and all organs of state, as well as section 8(2), which provides that the Bill of Rights applies to both natural and juristic persons; and section 237, which states that all constitutional obligations must be performed diligently and without delay. If all these provisions are read together, one principle is indisputable: the Constitution is supreme, and everything and everybody is subject to it. This means that the Constitution cannot be interpreted in the light of the Interpretation Act or the Roman-Dutch common law or traditional customary law. Everything and everybody, all law and conduct, all cultural traditions and legal dogmas and religious perceptions, all rules and procedures, and all theories, canons and maxims of interpretation are influenced and ultimately qualified by the Constitution<sup>251</sup>.

---

<sup>251</sup> 'The Constitution has changed the 'context' of all legal thought and decision-making in South Africa.' – Cameron J Holomisa v Argus Newspapers Ltd 1996 (2) SA 588 (W) 618



## The interpretation clause

Section 39(2) of the Constitution (the interpretation of statutes in general) provides:

‘When interpreting any legislation, and when developing the common law or customary law, every court, tribunal or forum must promote the spirit, purport and objects of the Bill of Rights.’

Section 39(2) deals with the interpretation of legislation other than the Bill of Rights. The Constitution does not expressly prescribe a contextual (purposive) approach to statutory interpretation. However, section 39(2) is a peremptory provision, which means that all courts, tribunals or forums must review the aim and purpose of legislation in the light of the Bill of Rights: plain meanings and so-called clear, unambiguous texts are no longer sufficient. Even before a particular legislative text is read, section 39(2) ‘forces’ the interpreter to promote the values and objects of the Bill of Rights. This inevitably means that the interpreter is consulting extra-textual factors before the legislative text is even considered. Factors and circumstances outside the legislative text are immediately involved in the interpretation process. In short, interpretation of statutes starts with the Constitution and not with the legislative text.<sup>252</sup> The Constitution should thus be applied in all aspects of South African law and be at the very centre of Statutory Interpretation<sup>253</sup>.

---

<sup>252</sup> ‘The Constitution is ... the starting point in interpreting any legislation. ... first, the interpretation that is placed upon a statute must, where possible, be one that would advance at least an identifiable value enshrined in the Bill of Rights; and, second, the statute must be capable of such interpretation ... The emerging trend in statutory construction is to have regard to the context in which the words occur, even where the words to be construed are clear and unambiguous.’ Ngcobo J - *Tourism 2004* (4) SA 490 (CC) paras 72, 80 and 90

<sup>253</sup> ‘The only material difference between that common-law approach and the present approach is the recognition that the previous constitutional system of this country was the fundamental ‘mischief’ to be remedied by the application of the new Constitution. ... For the Constitution, and particularly chapter 3 thereof, however, to fulfil its purpose it needs to become, as far as possible, a living document, and its contents a way of thinking, for all citizens of this country. The establishment of a culture of constitutionality can hardly succeed if the Constitution is not applied daily in our courts, from the highest to the lowest.’ - Froneman J *Qozeleni v Minister of Law and Order*



## **Practical, inclusive method of interpretation (Du Plessis)<sup>254</sup>**

Du Plessis proposes a 5 pointed model in (Re-) Interpretation of Statutes. The model is summarised as follows:

Words and phrases: the language aspect:

The linguistic and grammatical meaning of the words, phrases, punctuation, sentences and other structural components of the text and the rules of syntax are important considerations. However, this does not imply a return to the the orthodox text-based interpretation.

Structure and context: the systematic aspect:

This is also known as a holistic approach, and refers to the principle that words, phrases and provisions cannot be read in isolation. This extends beyond the text and requires one to consider inter alia, the political and social environments in which the statute operates.

Teleological interpretation: the value-based aspect:

The fundamental values in the Constitution form the foundation of a normative, value-laden jurisprudence during which legislation and actions are evaluated against (and filtered through) those constitutional values.

Historical aspect:

The historical context includes factors such as the circumstances which gave rise to the adoption of the legislation (mischief rule) and the legislative history (Prior legislation and preceding discussions). Although it is an important aspect of interpretation, the historical perspective cannot be decisive on its own.

Comparative aspect:

---

<sup>254</sup> Govender v Minister of Safety and Security 2001 (4) SA 273 (SCA)



This aspect refers to the process (if possible and necessary) during which the court examines the interpretation of similar legislation by foreign courts, as well as international law.

In chapter 2, this method is applied against a recent judgment by Wallis JA, in which he detailed the current acceptable method for interpretation in South Africa.





# The judgment of Natal Joint Municipal Pension Fund v Endumeni Municipality

Wallis JA in his judgement of Natal Joint Municipal Pension Fund v Endumeni Municipality provided a detailed view on how interpretation should be handed. This was of such significance many believe this has changed the standard for legal interpretation<sup>255</sup>.

Below is the dictum of Wallis JA:

[17] The trial judge said that the general rule is that the words used in a statute are to be given their ordinary grammatical meaning unless they lead to absurdity. He referred to authorities that stress the importance of context in the process of interpretation and concluded that:

“A court must interpret the words in issue according to their ordinary meaning in the context of the Regulations as a whole, as well as background material, which reveals the purpose of the Regulation, in order to arrive at the true intention of the draftsman of the Rules.”

Whilst this summary of the approach to interpretation was buttressed by reference to authority it suffers from an internal tension because it does not indicate what is meant by the “ordinary meaning” of words, whether or not influenced by context, or why, once ascertained, this would coincide with the “true” intention of the draftsman. There were similar difficulties in the heads of argument on behalf of Endumeni. In one paragraph they urged us, on the basis of the evidence of the actuary who advised the Fund to adopt the approach, that the proviso was not intended to cater for “a Maltman type of event” and in another cited authorities for the rule that the “ordinary grammatical meaning of the words used must be adhered to” and can only be departed from if that leads to an absurd result. In view of this, it is necessary to say something about the current state of our law in regard to the interpretation of statutes and statutory instruments and documents generally.’

Wallis JA highlights the difficulties of using the text based approach and uses this as an opportunity to discuss the current legal status of the interpretation of statutes in South Africa.

[18] Over the last century there have been significant developments in the law relating to the interpretation of documents, both in this country and in others that follow similar rules to our own. It is unnecessary to add unduly to the burden of annotations by trawling through the case law on the construction of documents in order to trace those developments. The relevant authorities are collected and summarised in *Bastian Financial Services (Pty) Ltd v General Hendrik Schoeman Primary School*. The present state of the law can be expressed as follows. Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming

---

<sup>255</sup> See the Taxpayer

into existence. Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production. Where more than one meaning is possible each possibility must be weighed in the light of all these factors. The process is objective not subjective. A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document. Judges must be alert to, and guard against, the temptation to substitute what they regard as reasonable, sensible or businesslike for the words actually used. To do so in regard to a statute or statutory instrument is to cross the divide between interpretation and legislation. In a contractual context it is to make a contract for the parties other than the one they in fact made. The “inevitable point of departure is the language of the provision itself”, read in context and having regard to the purpose of the provision and the background to the preparation and production of the document.’

Wallis acknowledges the importance of the legal text and the words used in it. Wallis however states that the words must be interpreted in context.

‘ [19] All this is consistent with the “emerging trend in statutory construction”. It clearly adopts as the proper approach to the interpretation of documents the second of the two possible approaches mentioned by Schreiner JA in *Jaga v Dönges and another, Bhana v Dönges and another* namely that from the outset one considers the context and the language together, with neither predominating over the other. This is the approach that courts in South Africa should now follow, without the need to cite authorities from an earlier era that are not necessarily consistent and frequently reflect an approach to interpretation that is no longer appropriate. The path that Schreiner JA pointed to is now received wisdom elsewhere. Thus, Sir Anthony Mason CJ said:

“Problems of legal interpretation are not solved satisfactorily by ritual incantations which emphasise the clarity of meaning which words have when viewed in isolation, divorced from their context. The modern approach to interpretation insists that context be considered in the first instance, especially in the case of general words, and not merely at some later stage when ambiguity might be thought to arise.”

More recently, Lord Clarke SCJ said “the exercise of construction is essentially one unitary exercise.”

It is submitted, that consistent with the Constitutional approach to interpretation, Wallis states that from the very beginning of the interpretation process, the language and contexts must be considered with equal preference.

[20] Unlike the trial judge I have deliberately avoided using the conventional description of this process as one of ascertaining the intention of the legislature or the draftsman, nor would I use its counterpart in a contractual setting, “the intention of the contracting parties”, because these expressions are misnomers, insofar as they convey or are understood to convey that interpretation involves an enquiry into the mind of the Legislature or the contracting parties. The reason is that the enquiry is restricted to ascertaining the meaning of the language of the provision itself. Despite their use by generations of lawyers to describe the task of interpretation it is doubtful whether they are helpful. Many judges and academics have pointed out that there is no basis upon which to discern the meaning that the members of Parliament or other legislative body attributed to a particular legislative provision in a situation or context of which they may only dimly, if at all, have been aware. Taking Parliament by way of example, legislation is drafted by legal advisers in a ministry, redrafted by the parliamentary draftsmen, subjected to public debate in committee, where it may be revised and amended, and then passed by a legislative body, many of whose members have little close acquaintance with its terms and are motivated only by their or their party’s stance on the broad principles in the legislation. In those circumstances to speak of an intention of parliament is entirely artificial. The most that can be said is that in a broad sense legislation in a democracy is taken to be a reflection of the views of the electorate expressed through their representatives, although the fact that democratically elected legislatures sometimes pass legislation that is not supported by or unpopular with the majority of the electorate tends to diminish the force of this point. The same difficulty attends upon the search for the intention of contracting parties, whose contractual purposes have been filtered through



the language hammered out in negotiations between legal advisers, in the light of instructions from clients as to their aims and financial advice from accountants or tax advisers, or are embodied in standard form agreements and imposed as the terms on which the more powerful contracting party will conclude an agreement.

[21] Alive to these difficulties there have been attempts to justify the use of the expression “the intention of the legislature” on broader grounds relating to the manner in which legislation is drafted and passed and the relationship between the legislature as lawgiver and the judiciary as the interpreter of laws. Francis Bennion, an eminent parliamentary draftsman and the author of a standard work on statutory interpretation, says that “Legislative intention is not a myth or fiction, but a reality founded on the very nature of legislation”. He bases this on the undoubtedly correct proposition that legislation is the product of the intentional volition of all participants in the legislative process so that:

“... Acts are produced down to the last word and comma, by people. The law maker may be difficult to identify. It is absurd to say that the law maker does not exist, has no true intention or is a fiction.”

However, that criticism misses the point. Critics of the expression “the intention of the legislature” are not saying that the law-maker does not exist or that those responsible for making a particular law do not have a broad purpose that is encapsulated in the language of the law. The stress placed in modern statutory construction on the purpose of the statute and identifying the mischief at which it is aimed should dispel such a notion. The criticism is that there is no such thing as the intention of the legislature in relation to the meaning of specific provisions in a statute, particularly as they may fall to be interpreted in circumstances that were not present to the minds of those involved in their preparation. Accordingly, to characterise the task of interpretation as a search for such an ephemeral and possibly chimerical meaning is unrealistic and misleading.

[22] The other objection raised by Bennion, that the idea that there is no true intention behind an Act of Parliament is undemocratic, suggests that the debate is being conducted at cross-purposes. In a constitutional democracy such as South Africa, or the United Kingdom, which is Bennion’s terrain, no-one denies that statutes and statutory instruments emanating from Parliament and other legislative bodies are the product of the democratic process. Interpretation always follows upon the democratic process leading to legislation and is, in that sense, a secondary and subordinate process. The interpreter does not write upon a blank page, but construes the words written by others. Nor is it denied that the broad purpose of the relevant legislative body (or legislator in the case of regulations or rules made by a functionary) is highly relevant to the process of interpretation, as is the mischief at which the legislation is aimed. Courts have repeatedly affirmed their importance and thereby respect the legislature’s role in a democracy. Courts do not set out to undermine legislative purpose but to give it effect within the constraints imposed by the language adopted by the Legislature. If “the intention of the legislature” was merely an expression used to encompass these matters as a form of convenient shorthand perhaps the matter would not have provoked so much comment. But the problem lies in it being said that the primary or “golden” rule of statutory interpretation is to ascertain the intention of the legislature. At one extreme, as has been the case historically, it leads to a studied literalism and denies resort to matters beyond the “ordinary grammatical meaning” of the words. At the other judges use it to justify first seeking to divine the “intention” of the Legislature and then adapting the language of the provision to justify that conclusion. It has been correctly said that:

“It is all too easy for the identification of purpose to be driven by what the judge regards as the desirable result in a specific case.”

When that occurs it involves a disregard for the proper limits of the judicial role.

Three Australian judges have sought to explain the use of the expression on other grounds. Gleeson CJ in *Singh v The Commonwealth* said:

“... references to intention must not divert attention from the text, for it is through the meaning of the text, understood in the light of background, purpose and object, and surrounding circumstances, that the legislature expresses its intention, and it is from the text, read in that light, that intention is inferred. The words ‘intention’, ‘contemplation’, ‘purpose’; and ‘design’ are used routinely by courts in relation to the meaning of legislation. They are orthodox and legitimate terms of legal analysis, provided their objectivity is not overlooked.”



French J described the intention of the Legislature as “an attributed intention based on inferences drawn from the statute itself” and added that it is “a legitimising and normative term” that “directs courts to objective criteria of construction which are recognised as legitimate.” In a broad ranging discussion of the concept, Spigelman CJ concludes that it is acceptable because the interpreter is concerned to ascertain the “objective” will of the Legislature or the contracting parties. However, in each instance the expression is being used either as a shorthand reference to something else or to convey a restricted and unrealistic meaning. If interpretation is, as all agree it is, an exercise in ascertaining the meaning of the words used in the statute and is objective in form, it is unrelated to whatever intention those responsible for the words may have had at the time they selected them. Their purpose is something different from their intention, as is their contemplation of the problem to which the words were addressed.

[24]The sole benefit of expressions such as “the intention of the legislature” or “the intention of the parties” is to serve as a warning to courts that the task they are engaged upon is discerning the meaning of words used by others, not one of imposing their own views of what it would have been sensible for those others to say. Their disadvantages, which far outweigh that benefit, lie at opposite ends of the interpretative spectrum. At the one end they may lead to a fragmentation of the process of interpretation by conveying that it must commence with an initial search for the “ordinary grammatical meaning” or “natural meaning” of the words used seen in isolation, to be followed in some instances only by resort to the context. At the other it beguiles judges into seeking out intention free from the constraints of the language in question and then imposing that intention on the language used. Both of these are contrary to the proper approach, which is from the outset to read the words used in the context of the document as a whole and in the light of all relevant circumstances.

That is how people use and understand language and it is sensible, more transparent and conduces to greater clarity about the task of interpretation for courts to do the same.

Wallis cautions against having concern to the intention of the legislature. He points out various flaws in this approach. The passing of legislation by parliament is not always evident of the masses but may rather be the views of that particular political party. It is also difficult and possibly incorrect to assume the legislator was cognisant of the exceptions to the legislation in question and therefore had a particular intention when drafting. Wallis cautions against a strict literal interpretation of the words (at the one extreme) and the substitution of meaning by judges to words used (the other extreme).

[25] Which of the interpretational factors I have mentioned will predominate in any given situation varies. Sometimes the language of the provision, when read in its particular context, seems clear and admits of little if any ambiguity. Courts say in such cases that they adhere to the ordinary grammatical meaning of the words used. However, that too is a misnomer. It is a product of a time when language was viewed differently and regarded as likely to have a fixed and definite meaning, a view that the experience of lawyers down the years, as well as the study of linguistics, has shown to be mistaken. Most words can bear several different meanings or shades of meaning and to try to ascertain their meaning in the abstract, divorced from the broad context of their use, is an unhelpful exercise. The expression can mean no more than that, when the provision is read in context, that is the appropriate meaning to give to the language used. At the other extreme, where the context makes it plain that adhering to the meaning suggested by apparently plain language would lead to glaring absurdity, the court will ascribe a meaning to the language that avoids the absurdity. This is said to involve a departure from the plain meaning of the words used. More accurately it is either a restriction or extension of the language used by the adoption of a narrow or broad meaning of the words, the selection of a less immediately apparent meaning or sometimes the correction of an apparent error in the language in order to avoid the identified absurdity.



[26] In between these two extremes, in most cases the court is faced with two or more possible meanings that are to a greater or lesser degree available on the language used. Here, it is usually said that the language is ambiguous although the only ambiguity lies in selecting the proper meaning (on which views may legitimately differ). In resolving the problem, the apparent purpose of the provision and the context in which it occurs will be important guides to the correct interpretation. An interpretation will not be given that leads to impractical, unbusinesslike or oppressive consequences or that will stultify the broader operation of the legislation or contract under consideration.'

It is clear that Wallis is of the opinion that interpretation should follow a holistic, objective approach. Consideration must be given to the language and text used as well as the context in which the statutes exists. The history of the texts and the meaning of the words at the time of writing must be considered in this process. The process of interpretation is not necessarily concerned with the intention of the legislator. Ultimately Wallis suggests that the process will vary from situation to situation but the interpreter must consider all aspects of the text in order to ascertain its true meaning.



## Annexure B - Calculation of interest as per the national credit act

The calculation of interest is prescribed by the regulations published in terms of the National Credit Act<sup>256</sup>. A starting point would be to give the very simple formula for the calculation of the amount of interest:

$$\text{The rand amount of interest for a day} = \frac{\text{Deferred amount for the day} \times \text{interest rate}}{\text{Number of days in the year.}}$$

This formula applies to all credit agreements except short-term credit transactions. The formula applicable to short-term credit transactions is:

$$\text{The rand amount of interest for a day} = \frac{\text{Deferred amount for the day} \times \text{monthly interest rate}}{\text{Number of days in the month.}}$$

Central to these calculations is the concept of deferred amount, the amount on which interest is calculated. The deferred amount is in essence the total amount of credit granted in terms of the agreement. More specifically, it includes the following<sup>257</sup>

- (a) any obligation deferred in accordance with section 8(3) and (4);
- (b) the initiation fee;
- (c) service fees;
- (d) interest;
- (e) credit insurance;
- (f) default administration charges; and
- (g) collection costs.

---

<sup>256</sup> National Credit Act No. 34 of 2005

<sup>257</sup> Adapted from **The National Credit Act Explained** : JM Otto BA LLB LLD (Pret)



In the case of instalment agreements, mortgage agreements, secured loans and leases, the following may also be added to the principal debt, if they are applicable:

- (a) the cost of an extended warranty;
- (b) delivery, installation and initial fuelling charges;
- (c) connection fees, levies or charges;
- (d) taxes, licence or registration fees; and
- (e) credit insurance premiums.

It is clear that the intended operation of these provisions is to limit the artificial increase of the effective interest rate (or more accurately the return on investment) through the use of fees.<sup>258</sup>

---

<sup>258</sup> Adapted from The National Credit Act Explained : JM Otto BA LLB LLD (Pret)



# References

## Articles Online

KPMG Advisory (China) Limited, *Proposals to apply VAT to the financial services sector in China* November 2013 from <https://assets.kpmg.com/content/dam/kpmg/pdf/2013/12/Proposals-to-apply-VAT-to-the-financial-services-sector-in-China-201311.pdf> [Accessed April 2016]

KPMG GLOBAL INDIRECT TAX SERVICES, *The 2013 Benchmark Survey on VAT/GST* from <https://assets.kpmg.com/content/dam/kpmg/pdf/2015/09/Tax-IndTax-2013-Benchmark-Survey-on-VAT-GST.pdf> [Accessed April 2016]

## Case Law

Bacal Contracting Ltd v Modern Engineering (Bristol) Ltd and others [1980] 2 All ER 655

Bhyat v Commissioner for Immigration 1932 AD 125 129

BLP Group plc v Commissioners of Customs and Excise [1996] 1 WLR 174

Cameron J Holomisa v Argus Newspapers Ltd 1996 (2) SA 588 (W) 618

Case No. VAT 382, Tax Court (Cape Town) 13 June 2011

Case No. VAT 382, Tax Court Cape Town 13 June 2011

Case No. VAT 382, Tax Court Cape Town, 13 June 2011

CIR v George Forest Timber Co Ltd 1924 AD 516

Coetzee v Rand Sporting Club 1918 WLD 74





Commissioner for SARS v De Beers (503/2011) [2012] ZASCA 103 (1 June 2012)

Commissioner for South African Revenue Service v Cape Consumers (Pty) Ltd (61 SATC 91), 23 March 1999.

Commissioner for South African Revenue Service v Cape Consumers (Pty) Ltd (61 SATC 91), 23 March 1999.

D v Commissioner for the South African Revenue Service (VAT 1390) [2016] ZAWCHC 72 (14 June 2016)

De Villiers in De Villiers v Cape Divisional Council 1875 Buch 50

ECLI:EU:C:2015:718 from:

(<http://curia.europa.eu/juris/document/document.jsf?text=&docid=170305&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=535347>)

Froneman J Qozeleni v Minister of Law and Order

Govender v Minister of Safety and Security 2001 (4) SA 273 (SCA)

Guernsey & Foreign Investment Trust Ltd v CIR 1938 CPD 158, 9 SATC 390

Income Tax Case No. 1744, 65 SATC 154 (2002)

Innes CJ in Venter v Rex 1907 TS 910

Jones & Co Ltd v CIR 1926 CPD 1, 2 SATC 7

KCM v C: SARS (VAT 711) [2009] ZATC 2 (14 August 2009)

Kommissaris Van Binnelandse Inkomste v Sive se Boedel 1963 (3) SA 847 (A) at 849A.

Kretztechnik AG v Finanzamt Linz Case C-465/03; [2005] STC 1118; [2005] 1 WLR 3755

Master Currency v C: SARS (155/2012) 2013 ZASCA 17

Ngcobo J - Tourism 2004 (4) SA 490 (CC)



Pyott Ltd v CIR 1945 AD 128 at 135 and 136

R v Hidick-Smith 1924 TPD 68 81

Randfontein Estates Gold Mining Co Ltd v Custodian of Enemy Property 1923 AD 576

Randfontein Estates Ltd v The Master, 1909 TS 978, at 981; Liquidators, Union Share Agency v Hatton, 1927 AD 240

See TCT Leisure (Pty) Ltd v C: SARS (2010) 3 All SA 325 (SCA), 72 SATC 187

Skatteverket v AB SKF Case C-29/08

Standard Bank of South Africa Ltd and others v Ocean Commodities Inc and others 1983 (1) SA 276 (A)

Wessels ACJ in Kilburn v Estate Kilburn 1931 AD 501 at 507

## **Acts of the Parliament of the Republic of South Africa**

Collective Investment Schemes Control Act No. 45 of 2002

Constitution of the Republic of South Africa, 1996

Companies Act No. 71 of 2008

Long Term Insurance Act No. 52 of 1998

National Credit Act No. 34 of 2005

Securities Transfer Tax Act, No. 25 of 2007

Securities Transfer Tax Administration Act No. 26 of 2007

Tax Administration Act No.28 of 2011

Usury Act No. 73 of 1968



Value-Added Tax Act No. 89 of 1991

## **Republic of South African Government Gazette**

Exchange Control Regulations as promulgated by Government Notice R.1111 of 1 December 1961 and amended up to Government Notice No. R.9 in Government Gazette No. 33926 of 14 January 2011

GN 141 GG 38503 of 25 February 2015: Declaration of hedge fund business as a Collective Investment Scheme.

## **Explanatory Memoranda**

National Treasury of the Republic of South Africa, Explanatory Memorandum on the Taxation Laws Amendment Bill 1996

## **Journals**

Davis D, Emslie T, van Dorsten & Dachs P, 'The Taxpayer' available from <https://shop.exacteditions.com/gb/the-taxpayer>

## **Commentary**

Otto J M, Otto R L (2015) , *The National Credit Act Explained*, LexisNexis, South Africa

De Koker AP , Bardenhorst G & Kruger D, *VAT in South Africa (2016)*, LexisNexis, South Africa



## Reports

Report of the Value-Added Tax Committee (VATCOM), Republic of South Africa 1990

South African Treasury, 2013 Budget Review, p. 63.

Tax Review Committee, Media Statement: *Release of Davis Tax Committee First Interim Report on VAT for Public Comment*, 7 July 2015 form <http://www.taxcom.org.za/docs/20150707%20DTC%20VAT%20First%20Interim%20Report%20for%20public%20comment.pdf>

The Competition Commission of South Africa (also known as the anti-trust committee) in its annual report in 2008. See also the Press Statement dated 25 June 2008.

Third Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa (1995)

Value Added Tax Committee (Article 398 Of Directive 2006/112/Ec) Working Paper No 836

## Reference books

International Accounting Standards Board, International Accounting Standard 18- Revenue (Illustrative Examples)

International Accounting Standards Board , International Accounting Standard 39 - Financial Instruments

Webster's New World College Dictionary Fifth Edition (2014)



## Financial Statement Extracts

ABSA Group Limited (Barclays Africa), Annual Financial Statements for financial years 2013, 2014, 2015 available from (<http://www.barclaysafrica.com/barclaysafrica/Investor-Relations/Announcements-and-publications/Financial-results>)

Investec Bank Limited (a subsidiary of Investec Limited), Annual Financial Statements for financial years 2013, 2014, 2015 available from <https://www.investec.co.za/about-investec/investor-relations/financial-information/year-end-results.html>

Nedbank Group Ltd, Annual Financial Statements for financial years 2013, 2014, 2015 available from (<https://www.nedbank.co.za/content/nedbank/desktop/gt/en/aboutus/information-hub/financial-results/2015.html>)

Standard Bank Group Limited, Annual Financial Statements for financial years 2013, 2014, 2015 available from <http://reporting.standardbank.com>

## Sundry

Council of South African Bankers and approved by the Commissioner for Inland Revenue (now SARS); issued on 15 August 1996 and effective as from 1 October 1996, *Value-Added Tax: Banking Services Provided and Fees Which May be Charged in Connection With Such Services*

Lewis M, *The Big Short* (2011), Penguin, New York

South African Revenue Service, Binding General Ruling 16 (2015)

South African Revenue Service, Draft Interpretation Note from <http://www.sars.gov.za/AllDocs/LegalDoclib/Drafts/LAPD-LPrep-Draft-2014-19%20-%20Draft%20IN%20VAT%20Treatment%20of%20Vouchers.pdf>



South African Revenue Services ruling issued to the Banking Association of South Africa  
dated 27 July 2006



# Legal Acronyms and Abbreviations

Acronym	Meaning
<b>A</b>	Atlantic Reporter [USA] (1855-1938)
<b>A 2d</b>	Atlantic Reporter, Second Series [USA] (1938- )
<b>A Crim R</b>	Australian Criminal Reports (1979- )
<b>AC</b>	The Law Reports, Appeal Cases [England] (1875- )
<b>ACSR</b>	Australian Corporations and Securities Reports (1989- )
<b>AD</b>	Appellate Division Reports [South Africa] (1910-1946)
<b>AHRLR</b>	African Human Rights Law Reports (2000- )
<b>AIR</b>	All India Reporter (1914- )
<b>AIR (SC)</b>	All India Reporter (Supreme Court) (1914- )
<b>AJIL</b>	American Journal of International Law (1907- )
<b>ALD</b>	Administrative Law Decisions [Australia] (1976- )
<b>All ER</b>	All England Law Reports (1936- )
<b>ALL ER (Comm)</b>	All England Law Reports ( Commercial cases [1999 - ] )
<b>All SA</b>	All South African Law Reports (1996- )
<b>ALR</b>	American Law Reports, Annotated (1913- )
<b>ALR</b>	Australian Law Reports (1895-1973 called Argus Law Reports) (1973- )
<b>ATR</b>	Australian Tax Reports
<b>BAC</b>	Buchanan's Appeal Cases [Cape] (1880-1911)
<b>BALR</b>	Butterworths Arbitration Awards [Butterworths Arbitration Law Reports] (1998- )
<b>BCLC</b>	Butterworths Company Law Cases (1983- )
<b>BCLR</b>	Constitutional Law Reports [South Africa] (1994- )
<b>BGB</b>	Bürgerliches Gesetzbuch (Civil Code) [Germany]
<b>BGH</b>	Bundesgerichtshof (Supreme Court) [Germany]



<b>BGHSt</b>	Entscheidungen des Bundesgerichtshof in Strafsachen (Criminal matters) [Germany] (1951- )
<b>BGHZ</b>	Entscheidungen des Bundesgerichtshof in Zivilsachen (Civil matters) [Germany] (1951- )
<b>BHRC</b>	Butterworths Human Rights Cases (1997- )
<b>BILC</b>	British International Law Cases (1964- )
<b>BLLR</b>	Butterworths Labour Law Reports [South Africa] (1994- )
<b>BLR</b>	Botswana Law Reports (1964- )
<b>Buch</b>	Buchanan's Supreme Court Reports [South Africa: Cape] (1868- 1879)
<b>Buch AC</b>	Buchanan's Appeal Court Reports [South Africa: Cape] (1880-1910)
<b>BVerfG</b>	Bundesverfassungsgericht (Federal Constitutional Court) [Germany]
<b>BverfGE</b>	Entscheidungen des Bundesverfassungsgericht [Germany]
<b>Cal Rptr</b>	California Reporter [USA] (1850- )
<b>CCC</b>	Canadian Criminal Cases (1893- )
<b>CCC (3d)</b>	Canadian Criminal Cases, Third Series (1983- )
<b>Ch</b>	The Law Reports, Chancery Division [England] (1891- )
<b>CILSA</b>	Comparative and International Law Journal of Southern Africa(1967- )
<b>CLJ</b>	Cambridge Law Journal (1921- )
<b>CLJ</b>	Cape Law Journal [became SALJ] (1884- )
<b>CLL</b>	Contemporary Labour Law
<b>CLR</b>	Commonwealth Law Reports [Australia] (1903- )
<b>CMLR</b>	Commonmarket Law Reports [Europe] (1962- )
<b>CPD</b>	Cape Provincial Division Reports [South Africa] (1910-1946)
<b>CR</b>	Criminal Reports [Canada] (1946-1967)
<b>CR (4<sup>th</sup>)</b>	Criminal Reports, Fourth Series [Canada] (1991- )
<b>CR (NS)</b>	Criminal Reports, New Series [Canada] (1967- )
<b>Cr. App.R</b>	Criminal Appeal Reports [England] (1916- )
<b>Cr. App.R.(S)</b>	Criminal Appeal Reports (Sentencing) [England] (1978- )





<b>CRR</b>	Canadian Rights Reporter (1982- )
<b>CRR (2d)</b>	Canadian Rights Reporter (2 <sup>nd</sup> series) (1991- )
<b>CTR</b>	Cape Times Reports [South Africa] (1891-1910)
<b>DLR</b>	Dominion Law Reports [Canada] (1912-1955)
<b>DLR (4<sup>th</sup>)</b>	Dominion Law Reports, Fourth Series [Canada] (1984- )
<b>ECJ CELEX</b>	Court of Justice of the European Communities and the Court of First Instance CELEX reports
<b>ECR</b>	European Court Reports. Reports of Cases before the Court of Justice of the European Communities (1954- )
<b>EDC</b>	Eastern Districts Court Reports [South Africa] (1880-1887, 1891-1909)
<b>EDL</b>	Eastern Districts Local Division Reports [South Africa] (1910-1946)
<b>EHHR</b>	European Human Rights Reports (1979- )
<b>EL</b>	Employment Law
<b>ER</b>	English Reports (1210-1865)
<b>Eur Ct HR</b>	European Court of Human Rights, Reports of Judgments and Decisions
<b>EWCA Civ</b>	As part of the new neutral citation format for British cases, denotes a case heard by the Court of Appeal Civil Division [England and Wales]
<b>EWHC (Ch)</b>	As part of the new neutral citation format for British cases, denotes a case heard by the High Court (Chancery Division) [England and Wales]
<b>EWHC (QB)</b>	As part of the new neutral citation format for British cases, denotes a case heard by the High Court (Queen's Bench Division) [England and Wales]
<b>EWHC (Admlty)</b>	As part of the new neutral citation format for British cases, denotes a case heard by the High Court (Admiralty) [England and Wales]
<b>EWHC (Fam)</b>	As part of the new neutral citation format for British cases, denotes a case heard by the High Court (Family Division) [England and Wales]
<b>F</b>	Federal Reporter [USA] (1880-1924)
<b>F 3d</b>	Federal Reporter, Third Series [USA]
<b>F Supp</b>	Federal Supplement [USA] (1932- )
<b>Fam</b>	The Law Reports, Family Division [England] (1972- )
<b>Fam LR</b>	Family Law Reports [Australia] (1975- )



<b>FCR</b>	Federal Court Reports [Australia] (1984- )
<b>FCR</b>	Federal Court Reports [Canada] (1971- )
<b>FLR</b>	Family Law Reports [England] (1980- )
<b>FLR</b>	Federal Law Reports [Australia] (1956- )
<b>Foord</b>	Cases decided in the Supreme Court of the Cape of Good Hope 1880
<b>FSR</b>	Fleet Street Reports [England] (1975- )
<b>GG</b>	Government Gazette [South Africa]
<b>GG</b>	Grundgesetz (Basic Law) [Germany]
<b>GN</b>	Government Notice [South Africa]
<b>GNR</b>	Government Notice Regulation [South Africa]
<b>GWLD</b>	Griqualand West Local Division Reports [South Africa] (1910-1946)
<b>HCG</b>	High Court of Griqualand Reports [South Africa] (1882-1910)
<b>HCTLR</b>	High Commission Territories Reports (1926-1966)
<b>HCTLR</b>	High Commission Territories Law Reports [Swaziland, Basutoland and Bechuanaland Appeal Court] (1926-1966)
<b>HGB</b>	Handelsgesetzbuch (Commerical Code) [Germany]
<b>Harv. L. Rev</b>	Harvard Law Review (1887- )
<b>HRQ</b>	Human Rights Quarterly (1979- )
<b>ICJ Rep</b>	International Court of Justice Reports (1947- )
<b>ICLQ</b>	International and Comparative Law Quarterly
<b>ILJ</b>	Industrial Law Journal [South Africa] (1980- )
<b>ILM</b>	International Legal Materials
<b>ILR</b>	International Law Reports (1950- )
<b>IR</b>	Irish Reports (1892- )
<b>JBL</b>	Journal of Business Law (1997- )
<b>JBL</b>	Juta's Business Law (previously Businessman's Law )(1997- )
<b>JDR</b>	Juta's Daily Reports [South Africa – on-line]
<b>JOC</b>	Judgments on Copyright



<b>JOL</b>	Judgments Online [South Africa]
<b>JTLR</b>	Juta's Tax Law Reports [South Africa] (1997- )
<b>Juta</b>	Juta's Supreme Court Reports (1880-1894)
<b>KB</b>	The Law Reports, King's Bench Division [England] (1901-1952)
<b>KLR</b>	Kenya Law Reports [1919 - ]
<b>L Ed</b>	United States Supreme Court Reports, Lawyers' Edition (1956- )
<b>LAC</b>	Labour Appeal Court [South Africa]
<b>LAC</b>	Lesotho Appeal Cases (1980- )
<b>LAWSA</b>	The Law of South Africa (Encyclopedia)
<b>LDD</b>	Law, Democracy and Development (1997- )
<b>LJ</b>	Law Journal Newspaper [England] (1866-1965)
<b>LJR</b>	Law Journal Reports [England] (1822-1949)
<b>Lloyd's Rep</b>	Lloyd's List Law Reports [England] (1950- )
<b>LLR-LB</b>	Lesotho Law Reports and Legal Bulletin (1967- )
<b>LMCLQ</b>	Lloyd's Maritime and Commercial Law Quarterly (1974- )
<b>LQR</b>	Law Quarterly Review (1885- )
<b>LRC</b>	Law Reports of the Commonwealth (1985- )
<b>LT</b>	Law Times Reports [England]
<b>Man R</b>	Manitoba Reports [Canada] (1883-1961) (2d 1979- )
<b>Menz</b>	Menzies' Supreme Court Reports [South Africa: Cape] (1828-1849)
<b>MLR</b>	Malawi Law Reports (1970- )
<b>MLR</b>	Modern Law Review
<b>NAC</b>	Native Appeal Court Reports [South Africa] (1927 until renamed BAC)
<b>NAC (C&amp;O)</b>	Native Appeal Court Reports (Cape and Orange Free State Division) [South Africa] (1928-1948)
<b>NAC (N&amp;T)</b>	Native Appeal Court Reports (Natal and Transvaal Division) [South Africa] (1928-1948)
<b>NAC (NE)</b>	Native Appeal Court Reports (North-Eastern Division) [South Africa] (1948- 1951)



<b>NE</b>	North Eastern Reporter [USA] (1884-1972)
<b>NE 2d</b>	North Eastern Reporter, Second Series [USA] (1972- )
<b>NJ</b>	Nederlandse Jurisprudentie [The Netherlands] (1913- )
<b>NLJ</b>	New Law Journal (1866- )
<b>NLR</b>	Natal Law Reports (New Series) [South Africa] (1879-1932)
<b>NJW</b>	Neue Juristische Wochenschrift (1949- )
<b>NPD</b>	Natal Provincial Division Reports [South Africa] (1933-1946)
<b>NR</b>	Namibian Law Reports (1990- )
<b>NSR</b>	Nova Scotia Reports [Canada] (1834-1929; 1965-1969) (2d 1969- )
<b>NSWLR</b>	New South Wales Reports [Australia] (1960- )
<b>NW</b>	North Western Reporter [USA] (1879-1941)
<b>NW 2d</b>	North Western Reporter, Second Series [USA] (1941- )
<b>NYS</b>	New York Supplement [USA] (1888-1938)
<b>NYS 2d</b>	New York Supplement, Second Series (1938 -)
<b>NZLR</b>	New Zealand Law Reports (1883- )
<b>OJ</b>	Official Journal of the European Communities
<b>OJLS</b>	Oxford Journal of Legal Studies (1981- )
<b>OPD</b>	Orange Free State Provincial Division Reports [South Africa] (1910-1946)
<b>OR</b>	Official Reports of the High Court of the South African Republic (1892-1899)
<b>OR</b>	Ontario Reports [Canada] (1992-1900; 1931-1973) (2d 1973- )
<b>ORC</b>	Orange River Colony Law Reports [South Africa] (1903-1909)
<b>P</b>	Pacific Reporter [USA] (1883-1931)
<b>P</b>	The Law Reports, Probate Division [England] (1872-1971)
<b>P 2d</b>	Pacific Reporter, Second Series [USA] (1931- )
<b>PC</b>	Privy Council
<b>PCIJ</b>	Permanent Court of International Justice Cases
<b>PH</b>	Prentice-Hall Weekly Legal Service [South Africa] (1923-1995)



<b>QB</b>	The Law Reports, Queen's Bench Division [England] (1891-1901 ; 1952- )
<b>Qd R</b>	Queensland Reports [Australia] (1958- )
<b>R&amp;N</b>	Rhodesia and Nyasaland Law Reports
<b>RGSt</b>	Entscheidungen des Reichsgericht in Strafsachen) (Criminal matters) [Germany] (1880-1945)
<b>RGZ</b>	Entscheidungen des Reichsgericht in Zivilsachen (Civil matters) [Germany] (1880-1945)
<b>RIAA</b>	United Nations Reports of International Arbitral Awards
<b>RLR</b>	Rhodesian Law Reports (1964-1980)
<b>Roscoe</b>	Roscoe's Supreme Court Reports [South Africa] (1861-1867; 1871-1872)
<b>RPC</b>	Reports of Patent Cases [England] (1884- )
<b>RR</b>	Revised Reports (1785- )
<b>RSC</b>	Revised Statutes Canada
<b>SA</b>	South African Law Reports (1947- )
<b>SASR</b>	South Australia State Reports (1922- )
<b>SACR</b>	South African Criminal Law Reports (1990- )
<b>SACJ</b>	South African Journal of Criminal Justice
<b>SAJELP</b>	South African Journal of Environmental Law & Policy (1994- )
<b>SAJHR</b>	South African Journal on Human Rights (1985- )
<b>SALJ</b>	South African Law Journal [Formerly Cape Law Journal] (1884- )
<b>SAR</b>	High Court Reports [South African Republic] (1881-1892)
<b>Sask R</b>	Saskatchewan Reports [Canada] (1979- )
<b>SAPR/PL</b>	South African Public Law (1986- )
<b>SATC</b>	South African Tax Cases (1926- )
<b>SC</b>	Cape Supreme Court Reports [South Africa: Cape] (1880-1910)
<b>SC</b>	Court of Sessions Cases [Scotland] (1906- )
<b>SCC</b>	Supreme Court Cases [India]



<b>SCLR</b>	Scottish Civil Law Reports (1987- )
<b>SCR</b>	Canada Law Reports (Supreme Court) (1876- )(from 1876-1922 called Canada Supreme Court Reports)
<b>SCR</b>	Supreme Court Reports [India] (1950- )
<b>S Ct</b>	Supreme Court Reporter [USA] (1882- )
<b>SE</b>	South Eastern Reporter [USA] (1887-1939)
<b>SE 2d</b>	South Eastern Reporter, Second Series [USA] (1939- )
<b>Searle</b>	Searle's Supreme Court Reports [ South Africa: Cape Town] (1850-1867)
<b>SLR</b>	Swaziland Law Reports (1963- )
<b>SLT</b>	Scots Law Times (1893- )
<b>So</b>	Southern Reporter [USA] (1887-)
<b>So 2d</b>	Southern Reporter, Second Series [USA]
<b>SR</b>	High Court of Southern Rhodesia Reports (1899; 1911-1955)
<b>Stell LR</b>	Stellenbosch Law Review (1990- )
<b>StGB</b>	Strafgesetzbuch (Penal Code) [Germany]
<b>StPo</b>	Strafprozeßordnung (Criminal Procedure Statute)
<b>SW</b>	South Western Reporter [USA] (1886-1928)
<b>SW 2d</b>	South Western Reporter, Second Series [USA] (1928- )
<b>Tax Cas</b>	Reports of Tax Cases [England] (1875- )
<b>TH</b>	Transvaal High Court Reports [South Africa] (1902-1910)
<b>THRHR</b>	Tydskrif vir Hedendaagse Romeins-Hollandse Reg
<b>TLR</b>	Tanzanian Law Reports (1983- )
<b>TLR</b>	Times Law Reports (1884-1952)
<b>TPD</b>	Transvaal Provincial Division Reports [South Africa] (1910-1946)
<b>TR</b>	Tasmanian Reports [Australia] (1979- )
<b>TS</b>	Transvaal Supreme Court Reports [South Africa] (1902-1909)
<b>TRW</b>	Tydskrif vir Regswetenskap / Journal for Juridical Science (1976- )
<b>TSAR</b>	Tydskrif vir die Suid-Afrikaanse Reg (1976- )



<b>UKHL</b>	As part of the new neutral citation format for British cases, denotes a case heard by the House of Lords
<b>UKPC</b>	As part of the new neutral citation format for British cases, denotes a case heard by the Privy Council
<b>UKSC</b>	United Kingdom Supreme Court Reports
<b>UNTS</b>	United Nations Treaty Series
<b>US</b>	Reports of Cases in the Supreme Court [USA] (1754- )
<b>USC</b>	United States Code
<b>USCA</b>	United States Code Annotated
<b>VR</b>	Victorian Reports [Australia] (1957- )
<b>VwGO</b>	Verwaltungsgerichtsordnung (Code of Administrative Procedure) [Germany]
<b>VwVfG</b>	Verwaltungsverfahrensgesetz (Administrative Law Code) [Germany]
<b>Watermeyer</b>	Watermeyer Supreme Court Cases [ South Africa: Cape] ( 1857 )
<b>WAR</b>	Western Australian Reports (1960 -)
<b>WLD</b>	Witwatersrand Local Division Reports [South Africa] (1910-1946)
<b>WLR</b>	Weekly Law Reports [England] (1953- )
<b>WWR</b>	Western Weekly Reports [Canada] (1911- )
<b>Yale LJ. /YLJ</b>	Yale Law Journal (1891- )
<b>ZLR</b>	Zimbabwe Law Reports (1980- )
<b>ZACC</b>	South African Constitutional Court Cases
<b>ZPO</b>	Zivilprozeßordnung (Civil Procedure Statute) [Germany]
<b>ZR</b>	Zambia Law Reports (1963- ) <sup>259</sup>

---

<sup>259</sup> Brand van Zyl Law Library, University of Cape Town, South Africa

