
# AN ANALYSIS INTO THE REFORM REQUIRED IN RESPECT OF THE VALUE-ADDED TAX TREATMENT OF EDUCATIONAL SERVICES

A research report to be submitted to the Faculty of Commerce, Law and Management in partial fulfilment of the requirements for the degree of Master of Commerce (Taxation)

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**ABSTRACT**

The aim of the report is to determine whether the current Value-Added Tax ('VAT') treatment relating to the exemption applied on educational services should be retained and to ascertain whether the policy considerations which applied when VAT was introduced are still relevant, or whether changed circumstances would justify the introduction of a different treatment or concessions in relation to these services.

The most critical and significant challenge being faced by VAT vendors and universities in particular is compliance with a vast array of amendments to the VAT Legislation, Binding Rulings, Guides and Interpretation Notes issued by the South African Revenue Service ('SARS'). Non-compliance for whatever reason may result in irregular expenditure and significant penalties and interest imposed for non-compliance, especially in light of the additional penalties being imposed in terms of the Tax Administration Act which was promulgated in October 2012. VAT therefore has a direct impact on the financial affairs and cash flow of VAT registered entities.

Furthermore, government funding in respect of tertiary institutions has been on the decline in recent years while the costs of running a tertiary institution have continued to be on the rise. This development has necessitated a change of approach in how tertiary institutions manage their operations. Consequently, there developed a strong need for tertiary institutions to find alternative ways of raising extra funds to make up for the shortfall caused by the decline in funding from government. The provision of short courses, in addition to the traditional full semester diploma and degree courses provided by the institutions, was identified as an opportunity to deliver a certain varied level of educational services to an existing suitable market. This opportunity presented attractive prospects as an alternative source of funding for the institutions in the wake of depleting government funding. In this regard, many of the institutions formed a number of vehicles in order to offer the short courses to the market. The rationale behind such approaches is in order to distinguish the traditional education services (diploma and degree courses) from the non-traditional educational services (short courses).

**Key Words**: Apportionment, compliance, education, educational services, exempt supply, GST, input tax, institution, OECD, SARS, standard rated, supply, tax reform, taxable, universities, Value-Added Tax, VAT, VATCOM, Welfare Organisation, zero rating.

**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.

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## CHAPTER 1 - INTRODUCTION

### Background

The South African VAT system displays characteristics of mostly a traditional VAT system, however a migration to a post-modern VAT system should be further considered where the supply of educational services is standard rated or zero rated within a certain threshold and is governed by a separate set of rules (Feria & Krever 2013).

At the outset when VAT was introduced in September of 1991, universities were predominantly state-funded institutions, and research activities were mostly funded by science councils and the Foundation for Research Development ('FRD') with no specific outcome or deliverables. In addition, the legislation that identified the boundaries of primary, secondary and higher education was not in position at the time and it proved difficult to distinguish between the various educational spheres. (Feria & Krever 2013)

As a consequence of the lack of clarity, the Value-Added Tax Committee ('VATCOM')[1] appointed by the Minister of Finance in 1991, recommended at the time that the supply of educational services should be exempt from VAT, akin to the previous sales tax treatment. The exemption was designed to alleviate the financial burden on universities and other higher learning institutions as well as additional risks and compliance costs associated with VAT accounting and compliance. (Carelse 2015)

Furthermore, the sector as a whole has now evolved to the point where it is possible to divide the education sector into categories by means of legislation, namely in the forms of the following classifications, such as basic education, which incorporates schools, technical vocational

[1] Following the issuing of the Draft VAT Bill for general comment on 18 June 1990, the Minister of Finance concurrently appointed a committee namely, the VATCOM consisting of members from both the public and private sectors to deliberate the comments and arguments made by interested parties in respect of the Draft VAT Bill.

education and training, which incorporates the various colleges and higher education which incorporates the universities (Carelse 2015).

In addition, research is also a defined focus area in which universities are now contracted by private entities for various types of research and consulting services. Expenses such as cleaning and security services are often no longer performed in-house, but rather performed by third-party service providers. From a VAT perspective, and with the emergence of various commercial research projects, and other income streams such as parking and gym facilities, most of the established institutions are now registered for VAT. As a result of institutions providing exempt and taxable supplies, they face tremendous challenges in managing their VAT risk in a very complex environment. (Owen *et al,* 2011)

Under current legislation universities' tuition fees, accommodation fees and state-funded research have no VAT implications. Certain contractual research, however and other membership fees are standard rated for VAT purposes. Thus, institutions have to calculate an apportionment ratio on an annual basis as a result of the generation of these mixed supplies. (De Koker & Kruger 2008)

SARS has issued a VAT Class Ruling ('VCR') to the Higher Education of South Africa ('HESA') in August 2012 to assist universities in accurately classifying their services and calculating the input tax deduction in respect of goods and services acquired for the purpose of making taxable supplies. However, managing VAT compliance in the sector and designating funds and expenses correctly for VAT purposes remains an area of concern for all institutions whilst in conjunction increasing complexity.

In terms of the VCR, the recovery rate in terms of the input tax claimable on overhead expenses such as water and electricity is limited to 12.5%. As a result, the sector incurs significant VAT costs in respect of VAT incurred on expenses for the purpose of educational services.

The primary intention of the South African VAT legislation is for the financial burden to eventually be borne by the final consumer. However, due to government and sector attempts in keeping the cost of education as low as possible in order to encourage further education, institutions are

finding themselves in positions where the funding of the VAT cost associated with the supply of exempt educational services is derived from internal resources. (Feria & Krever 2013)

In order to alleviate the financial and administration burden associated with VAT accounting, HESA on behalf of the sector was invited to give a presentation to the Davis Tax Committee[2](appointed by the Minister of Finance in July 2013) on a possible VAT reform for the sector. Following the presentation, a formal request was submitted whereby requesting the supply of educational services be made taxable at a reduced rate, similar to the current treatment of long-term commercial accommodation[3]. As a result, this in effect places the sector in a VAT-neutral position where the output tax payable on tuition fees would be funded by the additional input tax deduction that would become available. Not only would the VAT cost be reduced, but managing the VAT risk in the sector would in itself become a much simpler task. (Carelse 2015)

Furthermore, in the 2015 and 2016 National Budget Speech, the definition of educational services was raised as well as the VAT treatment of numerous expenditures. It was reported that the Davis Tax Committee is currently revising these VAT implications and that its conclusions may aid possible transformations.

Accordingly, the purpose of this paper will demonstrate the limited benefits and measurably larger compliance costs exemptions currently confer on the providers of educational services in South Africa. With particular reference being made to education institutions that are registered VAT vendors and are engaged in the generating of mixed supplies. A resultant factor of such complexity is often seen in the apportionment methods the institutions have to exercise which in turn increases the risk of noncompliance through errors and inconsistencies in the application of the law.

In addition, Chapter 2 will demonstrate the requirements for most education institutions to register as majority will have generated taxable supplies in excess of the threshold. Chapter 3 will

[2] In July 2013, the Minister of Finance announced the appointment of the Davis Tax Committee to examine the South African tax policy framework, and its function in supporting the objectives of inclusive growth, employment, development and fiscal sustainability.

[3] The 2014 HESA Annual report is attached herein as Annexure 4.

illustrate the changes made to the legislation over the years and the difficulties faced by the private education sector as a result. All section numbers referred in the report relate to the VAT Act unless specified otherwise. Due to the lack of communication by SARS in respect of the changes and inclusions in the legislation, many private sector educational institutions were found to be non-compliant as a result and have approached SARS for concession in this regard. The chapter will also highlight the differences in primary as opposed to tertiary education and the contrast in distinction between the two in terms of the different variable of educational services provided at each level.

Chapter 4 will outline the background and intention of the provision and the aim such policy intended to achieve by exempting education. This chapter will in addition establish whether such objectives are currently achieved and whether changes to policy is warranted. Chapter 5 will highlight the various issues and challenges faced by the education sector which are influencing factors that necessitate change. Chapter 6 will introduce the welfare organisation concession already in existence in the VAT framework and discussion surrounding the possibility of extending the concession to include educational services. Chapter 7 will contrast the VAT treatment adopted by other foreign jurisdictions similar and parallel to that of South Africa and highlight areas where a correlation is achieved between the two. The chapter will in addition compare and contrast the alternative VAT methods adopted in other tax jurisdictions in determining whether a more appropriate method exists to taxing educational services in South Africa, from a VAT perspective. This chapter will encompass a case study specific to Australia where educational services are zero rated, as the zero rating of educational services is one of the considerations proposed in this research paper.

Chapter 8 will highlight the additional challenges faced by the education sector with the introduction of the new VAT on e-commerce transactions in South Africa promulgated from 1 April 2014, and how the suppliers of education are unintentionally caught in the South African VAT net. Chapter 9 will discuss the complex apportionment calculations required to be performed by the providers of educational services and the concerns in terms of meeting the compliance requirements thereon. Chapter 10 will discuss the alternative measures and methods

of VAT treatment the State should consider bringing into the framework of the VAT system where educational services are concerned. In the event a more viable method of taxing educational services in South Africa exists, an analysis will be performed in theory to consider the potential impact of a new method on the economy and on the education sector as a whole.

In an ever changing tax domain, the adaption and evolution of the legislation to encompass such modifications is crucial in enabling progress and development. At the same time, the original intention and objective of the legislation should nevertheless embody the change and be considered an outline in terms of any new adoption. The exemption of educational services is one such adoption that warrants re-examination and change. The original intention as set forth by the VATCOM in progressing a form of education that is affordable to all, a tax system which is simple and one which demands the least amount of administrative burden is no longer feasible and is a concept that cannot economically function in the here and now.

**Research problem and sub-problems**

Should the current VAT treatment relating to the exemption applied on educational services be retained or does the changed circumstances in relation to the education sector warrant the introduction of a different treatment or concessions in relation to these services?

The first sub–problem is to evaluate the current design of the VAT treatment of educational services in South Africa, together with the evolution of education over the past 20 years and how exponentially educational institutions have grown with the further need of additional funding in order to meet the growing demands of a society at large. Private educational institutions including those partially subsidized by the government are compelled to seek alternative forms of funding in order to operate and provide education at a quality that is socially acceptable and on par with the rest of the world. The VAT exemption applied with regards to education, that was founded to enhance social development can no longer be used as a motive towards its continued use as its inefficiencies are found to outweigh the welfare it was necessitated to attain. The compulsory requirement to register for VAT has become a tangible need for most education institutions as they generate a mixture of supplies in excess of the VAT threshold and are required to perform complex high level apportionment ratio calculations in terms of their supplies as a

result. In addition the burden of extensive costs the government endeavoured to remove has inadvertently shifted to the student to assume if the current legislation is followed.

The second sub-problem synthesises the research in comparison to the legislation currently adopted by other jurisdictions, for example New Zealand, the United Kingdom and Australia with regards to the treatment of similar supplies and asks whether the current regime adopted in South Africa is consistent with the notions thus derived. The sub-problem also seeks to address the original intention of the legislation in exempting education and whether the intention is still being satisfied in the current education environment. This also raises the concern whether such VAT treatment is relevant or whether different standards should be derived towards adopting a more suitable approach to taxing educational services in South Africa for additional deliberation by South African policy makers.

The third sub-problem deals with the numerous issues and difficulties currently faced by the educational sector. The problem also seeks to address the extent of reform necessary and the pretext and motive into what can potentially be achieved. An extension of which is where a provider of educational services cannot recover the VAT paid on its services, the irrecoverable VAT forms part of the cost. The provider may choose to either raise the price of its services, absorb the VAT cost or find an alternate way of delivering the same service without the VAT cost. It is in instances such as these that result in the student having to endure and absorb the additional cost levied by the education provider as a result.

The fourth sub-problem arises from the theory that in principle the Value-Added Tax Act 89 of 1991 ('the VAT Act') does already cater for and provides benefits in certain circumstances for example, the welfare organisation concession provided. It is argued that such an arrangement be extended to the supply of educational services. The inclusion of educational services as a welfare activity will entitle entities to claim deductions on additional expenditure and costs incurred, which would accordingly relieve the burden of trapped VAT[4].

[4] The South African VAT legislation provides for the denial of input tax on costs incurred to generate exempt supplies. Thus the supplier is denied input tax relief on expenses incurred to generate such supplies. The burden of an irrecoverable VAT cost exposes the education industry to deterrents where such costs are inevitably passed on to the student to assume.Furthermore,

The last sub-problem discusses the challenges faced by the providers of educational services in performing complex apportionment ratios and the alternatives that should be implemented in alleviating some of the burdens placed on the higher education sector, whilst in alignment with the legislations original intention.

**Purpose of the research**

The purpose of the report is to determine whether the current VAT treatment relating to the exemption applied on educational services should be retained and to ascertain whether the policy considerations which applied when VAT was introduced are still relevant, or whether changed circumstances would justify the introduction of a different treatment or concessions in relation to these services.

This research report will, primarily, give an overview of the current VAT exemption in respect to educational services and the challenges faced by the education sector and the industry as a whole. This study is designed to give the reader an overview of the intention of the exemption, the aspired objective in its application and the surrounding concerns that warrant much needed change. As educational services is a current topic in many tax forum agendas, this study will also give an overview of the alternative methods and applications the State can adopt in reliving some of the current burden placed on the sector in terms of compliance whilst remaining true to the legislation's original intention.

**Significance of the study**

The treatment of educational services is a current crucial topic that needs to be discussed in depth. With the recent strikes by university students demanding for the decrease in the amount of tuition fees charged, SARS and the State need to take active steps in addressing the challenges faced by the education sector and the industry as a whole.

This study in addition, provides the much needed analysis of alternative VAT methods adopted by other jurisdictions in respect of the taxing of educational services, with the primary intention

Adam Smith (1776) states that VAT rules should be outlined in such a way that they are not the underlying driver for business decisions.

of the study being to determine whether a revision in the South African VAT policy is necessitated in this regard.

**Scope**

The scope of the study will focus on the specific areas surrounding the provision of educational services where the most challenges are faced. For example, the area concerning the complex apportionment calculations required to be performed by the providers of educational services, the additional costs borne by the institutions and the amendments in the legislation that impact the sector as a whole.

**Limitations**

It is pertinent to iterate that this research has made no attempt to examine the various socio-economic factors which would affect the implementing of a change to the VAT system in South Africa. This is an inherent limitation of the study. The study does, however, make an important theoretical contribution by considering the alternative methods and VAT treatment the State can adopt with respect to educational services. Not only by outlining the proposed taxation reforms but also highlighting the possible negative consequences and overall impact of introducing such taxation reforms without thorough consideration.

To ensure that education is made affordable to the people of South Africa and for the students to obtain the benefits envisioned for them by the policy, it is imperative that the State maintain transparency, consider the experiences and knowledge that can be obtained from looking abroad, and that it firmly uphold the principles of the Constitution. This report has provided the basis for further research in this regard. While the report made no attempt to investigate the socio-economic impact of the proposed taxation reforms in South Africa, such research would aid in improving the proposals for change to the South African VAT framework in respect to educational services. By highlighting the pros and cons of the proposed taxation reforms with respect to the VAT treatment of education, this report has provided the foundation for further research into what the optimal VAT treatment would be for the South African education sector.

## Methodology

The research method adopted consists of a review of the relevant provisions of the various Acts, agreements entered into by the South African National Treasury relevant to this research, publications by the South African National Treasury, publications by SARS, discussion papers relevant to this research, South African and international textbooks, policies, guidelines, legislation and case law as well as international government reports issued relating directly to the objective of this research.

A comprehensive literature review and examination will be undertaken that incorporates the following sources –

- Books;
- Cases;
- Electronic databases;
- Electronic resources – internet;
- Journals;
- Government reports;
- Publications; and
- Statutes.

## CHAPTER 2 – LIABILITY OF PROVIDERS OF EDUCATIONAL SERVICES TO REGISTER AS VAT VENDORS IN SOUTH AFRICA

### VAT registration requirements

In terms of the South African VAT legislation, an entity is required to register as a VAT vendor in SA where it:

- carries on an 'enterprise' in South Africa as defined in section 1of the VAT Act; and
- generates taxable supplies in excess of R 1 million; or
- at the commencement of any month where the total value of the taxable supplies in terms of a contractual obligation in writing to be made by that person in the period of 12 months from the commencement of the said month exceeds R 1 million.

Section 23 of the VAT Act requires the existence of an enterprise, which would mean that a person should first fall within the definition of 'enterprise' before it becomes liable to register for VAT purposes. The definition of 'enterprise' in section 1 of the VAT Act should be analysed to ascertain whether the activities of the company falls into 'enterprise'. Bearing in mind that the South African VAT legislation does not contain 'place of supply' rules, the determining factors for whether or not an activity constitutes an 'enterprise' in South Africa must be interpreted from the definition. (Silver & Beneke 2015)

'Enterprise' is defined in section 1 of the VAT Act as:

> in the case of any vendor, any enterprise or activity which is carried on continuously or regularly by any person in the Republic or partly in the Republic and in the course or furtherance of which goods or services are supplied to any other person for a consideration, whether or not for profit.

In order to ascertain if an entity meets the criteria of an enterprise as outlined in the definition, some of the more important aspects of the definition is required to be analysed:

‘Any enterprise or activity’

The first requirement of an enterprise is the existence of an enterprise or activity. Since the word enterprise is used in the definition, it takes on its normal meaning. The Oxford Dictionary defines ‘enterprise’ as a ‘project or undertaking, a business or company’. ‘Activity’, is further defined as a ‘thing that a person or group does or has done, the condition in which things are happening or being done’.

The use of the word ‘activity’ has the effect of substantially broadening the meaning of an enterprise and it is therefore not confined to business or profit making activities alone. The enterprise or activity however, will only be a VAT enterprise if various other components of the definition are satisfied.

‘Continuous or regular’

According to SARS ‘continuously’ is generally interpreted as ongoing. The duration of the activity has neither ceased in a permanent sense, nor has it been interrupted in a substantial way. The term ‘regular’ refers to an activity which takes place repeatedly (Silver & Beneke 2015).

The New Zealand’s Revenue Authorities Tax Information Bulletin Vol 7 No 3[5], provides further guidance hereon i.e. an activity is ‘continuous’ if there is no significant interruption of the activity. In other words, it is carried on all the time. Temporary interruptions in the activity for a holiday or for health reasons, for example, will not generally mean that that activity is not ‘continuous’. An activity furthermore is ‘regular’ if it is repeated at reasonably fixed intervals.

‘In the Republic or partly in the Republic’

As there is no definite guidelines in terms of when an activity is carried on partly in the Republic, and because the VAT Act does not contain particular place of supply rules, uncertainties often arise when determining the South African VAT status of international educational institutions making supplies to South African educational service providers or enterprises.

[5] IRD Tax Information Bulletin: Volume Seven, No.3 (September 1995).

‘Republic' as defined in section 1 of the VAT Act includes

‘the territory of the Republic of South Africa and the territorial waters, the contiguous zone and the continental shelf’.

‘Partly in the Republic’ on the other-hand refers to an activity which is carried on in an export country as well as in the Republic. Furthermore, no minimum scope of activity in the Republic is required.

‘Goods or services are supplied to any other person for a consideration, whether or not for profit’

‘Consideration’, as defined in section 1 of the VAT Act includes:

> [a]ny payment made or to be made (including any deposit on any returnable container and tax), whether in money or otherwise, or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods or services, whether by that person or by any other person.

The above, however does not include any payment made by any person as a donation to any association not for gain. Furthermore, a deposit (other than a deposit on a returnable container), whether refundable or not, given in respect of a supply of goods or services shall not be considered as payment made for the supply unless and until the supplier applies the deposit as consideration for the supply or such deposit is forfeited. (Silver & Beneke 2015)

Numerous educational institutions within South Africa conduct an enterprise with the rendering of taxable supplies in addition to the provision of educational services (De Koker & Kruger 2008). Such additional activities, provided the educational institute qualifies for and is VAT registered, are taxed at the standard rate. This in turn has created complications in administering the VAT Act, whereby these service providers are then required to carry out an apportionment of VAT to encumber the mixed supplies. This practice is inefficient and not cost effective. Furthermore the ease of compliance which was the basis in implementing the exemption is diminished as registration for VAT purposes is unavoidable. (Carelse 2015)

## CHAPTER 3 – THE CURRENT VAT LEGISLATION

The purpose of this chapter is to set out the background and current legislative framework in relation to educational services in South Africa. As the term educational services is not defined in either the VAT Act or in respect of the various Acts referenced in section 12(*h*), it stands to argue that educational services can only be termed or defined in terms of what it includes. Thus, while 'educational services' have not been specifically defined in the VAT Act, it is nevertheless clear that services covered by the referenced Acts below is included in the definition. Moreover, in terms of subsection (ii) to section 12(*h*), a clear reference has been made as to what 'educational services' is envisaged to include. Furthermore, this chapter will discuss the various changes made over the years and the anomaly created with specific reference to the amendment to section 12(*h*) that brought about the inclusion of private Further Education and Training Colleges ('FETs') into the exemption.

### The Current VAT Legislation

Section 7(1) of the VAT Act provides that where goods or services are supplied by a vendor in the course of his enterprise carried on by him, such services or goods shall be subject to VAT at the standard rate of 14% provided certain exemptions and zero-rating provisions do not apply.

Educational services are deemed to be an exempt supply in terms of section 12(*h*) of the VAT Act. The main reason for the exemption of educational services, is that many of the institutions providing educational services were government institutions and to some extent financed by the government (Thomson 1974). Over the years, however the activities of institutions providing educational services have changed drastically and a reduced number of institutes are wholly subsidized in terms of government subsidies (Alderman & Del Ninno 1999). In order to aid government grants and increase income, these institutions have increased their taxable activities considerably. Furthermore, privately owned and semi-subsidized institutions are accountable for their own costs and are not provided any or limited subvention from the State (Carelse 2015).

As highlighted previously, numerous educational institutions within South Africa conduct an enterprise with the rendering of taxable supplies in addition to the provision of educational services. Where these institutions are registered VAT vendors, such additional activities are taxed at the standard rate. This in turn has created complications in administering the VAT Act, whereby these service providers are then required to carry out an apportionment of VAT to encumber the mixed supplies.

Section 12(*h*) of the VAT Act provides that the following supply of services shall be exempt from VAT:

The supply of educational services-

(*aa*) provided by the State or a school registered under the South African Schools Act, 1996 (Act No. 84 of 1996), ['Schools Act'] or a public college or private college established, declared or registered as such under the Further Education and Training Colleges Act, 2006 (Act No. 16 of 2006);['FET Act']

(*bb*) by an institution that provides higher education on a full time, part-time or distance basis and which is established or deemed to be established as a public higher education institution under the Higher Education Act, 1997 (Act No. 101 of 1997) ['Higher Education Act'], or is declared as a public higher education institution under that Act, or is registered or conditionally registered as a private higher education institution under that Act; [Emphasis added].or

(*cc*) by an institution in the Republic which is exempt from income tax in terms of section 30 of the Income Tax Act and which has been formed for the-

(A) promotion of adult basic education and training including literacy and numeracy education, registered under the Adult Basic Education and Training Act, 2000 (Act No. 52 of 2000),['Adult Training Act'] vocational training or technical education;

(B) promotion of the education and training of religious or social workers;

(C) training or education of persons with a permanent physical or mental impairment;

(E) provision of bridging courses to enable indigent persons to enter a higher education institution as envisaged in subparagraph (*bb*); or

(ii) the supply by a school, university, technikon or college solely or mainly for the benefit of its learners or students of goods or services (including domestic goods and services) necessary for and subordinate and incidental to the supply of services referred to in subparagraph (i) of this paragraph, if such goods or services are supplied for a consideration in the form of school fees, tuition fees or payment for board and lodging;

(iii) the supply of services to learners or students or intended learners or students by the Joint Matriculation Board referred to in section 15 of the Universities Act, 1955 (Act No. 61 of 1955) ['University Act']:

Provided that vocational or technical training provided by an employer to his employees and employees of an employer who is a connected person in relation to that employer does not constitute the supply of an educational service for the purposes of this paragraph.

The different types or categories of education are not specifically defined in the VAT Act but in each instance is defined in terms of a specific Act. As evident from the above, a vast array of educational institutions may qualify as supplying education as envisaged in the VAT Act. As 'educational services' are not specifically defined in the VAT Act, reference to the educational services supplied in terms of the specific referenced Acts is required.

The various educational services, as envisaged in section 12(*h*), are examined in further detail hereunder.

The Further Education and Training Colleges Act, 2006 (Act No. 16 of 2006):

For private colleges to fall within the ambit of the above exemption, they have to be established, declared or registered under the FET Act. The FET Act was amended with the Further Education and Training Colleges Amendment Act (Act 1 of 2013), dated 19 March 2013. Where FET's meet the definition of a private college that offers continuing education and training and is established, declared or registered as such under the FET Act, the supplies of its educational services will be exempt from VAT. (Silver & Beneke 2015)

Private colleges are not administered by local, state or national governments and thus, they retain the right to select their students and are funded in whole or in part by charging their students tuition, rather than relying on mandatory public or government funding. Private colleges operate in terms of securing contracts in order to provide training to companies and individuals. A large percentage of the services are provided to VAT vendors. In order to supply the training services, these institutions outsource the services to specialised training providers. Typically, the outsourcing company or sub-contractor charges VAT at the standard rate to these companies for the provision of such training services. (Lomofsky & Lazarus 2001)

The list of Registered Private FETs as updated on 09 January 2012 refers. This list serves as the National Register of Private FET colleges and is published in accordance with Regulation 15(3) of the Regulations for the Registration of Private Further Education and Training, 2007[6].

The FET Act defines the institutes as follows:

- **college** – to mean a public or private further education and training institution that is established, declared or registered under this Act, but does not include –
  - *(a)* a school offering further education and training programmes under the South African Schools Act; or
  - *(b)* a college under the authority of a government department other than the Department.
- **private college** – to mean any college that provides further education and training on a full-time, part-time or distance basis and which is registered or provisionally registered as a private college under this Act.
- **public college** - to mean any college that provides further education and training on a full-time, part-time or distance basis and which is –
  - *(a)* established or regarded as having been established as a public college under this Act; or declared as a public college under this Act.

The FET Act does not define educational services but has made provision for the term 'general education'. This in essence is made to signify the compulsory school attendance phase as contemplated in section 3 of the South African Schools Act.

The Schools Act defines the term school as follows:

- **School** – to mean a public school or an independent school which enrols learners in one or more grades from grade R (Reception) to twelve.

The Higher Education Act defines the subsequent terms as follows:

- **Higher education** –to mean all learning programmes leading to qualifications higher than grade 12 or its equivalent in terms of the National Qualifications Framework as contemplated in the South African Qualifications Authority Act, 1995 (Act No. 58 of 1995) ['SA Qualifications Act'], and includes tertiary education as contemplated in Schedule 4 of the Constitution.
- **Grade 12** – to mean the highest grade in which education is provided by a school as defined in the South African Schools Act, 1996 (Act No. 84 of 1996).

[6] The list of Registered Private FETs as updated on 09 January 2012 is attached herewith as Annexure 2.

- **Higher education institution** – to mean any institution that provides higher education on a full-time, part-time or distance basis and which is-

  (*a*) established or deemed to be established as a public higher education institution under this Act;
  (*b*) declared as a public higher education institution under this Act; or
  (*c*) registered or conditionally registered as a private higher education institution under this Act;

- **Private higher education institution** – to mean any institution registered or conditionally registered as a private higher education institution in terms of Chapter 7.
- **Public higher education institution** – to mean any higher education institution that is established, deemed to be established or declared as a public higher education institution under this Act.
- **Technikon** – to mean any technikon established, deemed to be established or declared as a technikon under this Act.
- **University** – to mean any university established, deemed to be established or declared as a university under this Act.

The Schools Act, similar to the FET Act and Higher Education Act, does not appear to specifically define 'educational services'. It is evident, however, from the different educational services addressed by each Act, that primary education is distinguishable from tertiary education.

As previously highlighted educational services are not defined within the VAT Act. However, subsection (ii) of 12(*h*), includes:

> the supply by a school, university, technikon or college solely or mainly for the benefit of its learners or students of goods or services (including domestic goods and services) necessary for and subordinate and incidental to the supply of services above if such goods or services are supplied for a consideration in the form of school fees, tuition fees or payment for board and lodging.

Therefore, where additional goods and services are not supplied as part of the consideration for and payment of the tuition fees, school fees or fees or payment for board and lodging, they will fall outside this category and will be subject to VAT.

Conclusion

As the term educational services is not defined in either the VAT Act or in respect of the various Acts referenced in section 12(*h*), it stands to argue that educational services can only be termed or defined in terms of what it includes. Thus, while 'educational services' have not been specifically defined in the VAT Act, it is nevertheless clear from the above analysis that services covered by the referenced Acts is included in the definition. Moreover, in terms of subsection (ii) to section 12(*h*), a clear reference has been made as to what 'educational services' is envisaged to include. (Silver & Beneke 2015)

**History of Amendments**

Similar to the importance of examining the intention of the legislation, the amendments to section 12(*h*) similarly be examined in assessing the VAT treatment of 'educational services' further. Furthermore, an analysis into the anomaly created with the amendments to section 12(*h*) that brought about the inclusion of the private FETs into the education exemption.

Prior to 01 March 2002, section 12(*h*) of the VAT Act provided that the following supplies are exempt from VAT:

> The supply by the state (including any provincial administration) or any institution of a public character of any educational services-
>
> *a)* in respect of primary or secondary education in any school or pre-primary school education provided in any institution which meets the requirements of any recognized educational authority; or
>
> *b)* in any technikon established or deemed to have been established or declared to be such under any Act of Parliament; or
>
> *c*) in any educational institution established by or under any other law of the Republic which is in all material respects similar to a technikon referred to above;
>
> *d)* in any university established by an Act of Parliament or in any university college established under the Tertiary Education Act, 1988 (Act No. 66 of 1988)['Tertiary Education Act']; or
>
> *e)* in any permanent institution in the Republic approved by the Minister for the purposes of section 18A of the Income Tax Act which has been formed-
>
> i. for the promotion of adult education, vocational training or technical education; or

ii. to promote the education and training of religious or social workers; or

iii. for the education of training of physically or mentally handicapped persons;…

The Second Revenue Laws Amendment Act 2001 which came into effect on 1 March 2002, amended the above section as follows:

the supply of educational services—

a) provided by the State or a school registered under the South African Schools Act, 1996 (Act No. 84 of 1996), or a further education and training institution established by the State or such institution registered under the Further Education and Training Act, 1998 (Act No. 98 of 1998);[Emphasis added]

b) by an institution that provides higher education on a full time, part-time or distance basis and which is established or deemed to be established as a public higher education institution under the Higher Education Act, 1997 (Act No. 101 of 1997), or is declared as a public higher education institution under that Act, or is registered or conditionally registered as a private higher education institution under that Act; or

c) by an institution in the Republic which is exempt from income tax in terms of section 30 of the Income Tax Act and which has been formed for the—

I. promotion of adult basic education and training including literacy and numeracy education, registered under the Adult Basic Education and Training Act, 2000 (Act No. 52 of 2000), vocational training or technical education;

II. promotion of the education and training of religious or social workers;

III. training or education of persons with a permanent physical or mental impairment;

IV. training of unemployed persons with the purpose of enabling them to obtain employment; or

V. provision of bridging courses to enable indigent persons to enter a higher education institution as envisaged in subparagraph (b); or…

This amendment to section 12(*h*) brought about the inclusion of FETs into the exemption. According to the Explanatory Memorandum on the Second Revenue Laws Amendment Bill, 2001, paragraph 154, the amendment was promulgated to bring the requirements for VAT exemption in line with the new education legislation.

On 6 June 2005 in the Government Gazette No. 27660 the Minister of Education appealed for submission of applications from existing private institutions offering full qualifications that are registered at Level 2 to 4 of the National Qualifying Frameworks. The closing date for the submission of these applications was 30 May 2006. This date applied to private institutions that were offering FET qualifications as at 30 May 2006.

In a subsequent notice that was published by the Minister of Education in Government Gazette No 28911 of 1 June 2006, with effect from 1 January 2008, no person, other than a public FET institution or an organ of State, shall be allowed to offer FET qualifications (qualifications at NQF Levels 2 to 4) unless such a person is registered or provisionally registered as a private FET institution with the Department of Education ('DoE'). Any person who contravenes the FET Act by not registering is guilty of an offence and is liable on conviction to a fine or imprisonment not exceeding five years or to both fine and imprisonment. This in turn resulted in the prompt registration of multiple FETs with the DoE.

Introduction of the Revenue Laws Amendment Act No 60 of 2008.

Section 12(*h*) was amended with the replacement of:

> the supply of educational services provided by the State or a school registered under the South African Schools Act, 1996 (Act No. 84 of 1996), or a further education and training institution established by the State or such institution registered under the Further Education and Training Act, 1998 (Act No. 98 of 1998); to
>
> 'the supply of educational services provided by the State or a school registered under the South African Schools Act, 1996 (Act No. 84 of 1996), or public college or private college established, declared or registered as such under the Further Education and Training Colleges Act, 2006 (Act No. 16 of 2006). [Emphasis added]

The public or private colleges as defined in the FET Act and the requirements for registration under this Act were the same when compared to the Further Education and Training Act, 1998. A noticeable difference to section 12(*h*) was however, the inclusion of the words 'established, declared' or registered as opposed to the previously 'registered' in section 12(*h*). No explanation was provided in the Explanatory Memorandum to the 2008 Amendment Bill. Therefore, in this

regard, we need to consider the ordinary dictionary meaning of such words for further guidance. (Silver & Beneke 2015)

As defined in the Oxford Dictionary:

> 'Established' means, set up on a firm or permanent basis;
>
> 'Declared' means formally announce the beginning of (a state or condition), say something in a solemn and emphatic manner, and reveal one's intentions or identity'.

It can therefore be interpreted that the change in terms of section 12(*h*) brought about the requirement for private FETs even though not registered under the appropriate FET Act, to still qualify for the exemption from VAT if the institution was set-up or performs the operations associated with a private FET. Many entities that were not registered under the FET Act did not fall within the exemption as per the previous section 12(*h*). This has created the anomaly that FETs that were not compliant by registering under the FET Act did not make exempt supplies and therefore could charge VAT at 14% and claim input tax on expenses rightfully whereas FETs that were registered were now treating their supplies incorrectly from a VAT point of view. By complying with the FET Act, institutions were now penalized from a VAT point of view making their services more expensive as the VAT was trapped compared to those who were not complying. (Silver & Beneke 2015)

Conclusion

The reasons for including private FETs into the VAT exemption remain unclear. Clarity is required in terms of whether it was always the intention to treat private commercial educational entities in the same manner as state-owned educational entities. Arguably, the above changes in legislation were not properly communicated to the industry, which is evidenced by the fact that VAT is charged on these services (Lomofsky & Lazarus 2001). The above statement is made by drawing comparisons to the change in policy that affected the Municipal Industry following the Minister's Budget speech in 2006 regarding the zero-rating of municipal rates and the VAT implications to Municipalities.

In this regard, it should be noted that specific guidelines and timelines were put in place to assist with the transition. This included various discussions held between National Treasury, SARS and municipal employees. Transitional arrangements were published and VAT guides were discussed and prepared in relation thereto. Furthermore, an announcement was made in the Minister's Budget speech on 15 February 2006 that municipal property rates will be zero-rated for VAT purposes with effect from 1 July 2006. In addition, discussion sessions were held with National Treasury to discuss budget proposals. National Treasury and SARS held various information sessions and workshops in various provinces to discuss the law amendments with municipal finance employees and accounting officers after amendments were promulgated. Transitional Arrangements were published in Regulation 270 (28 March 2007)[7] and on the 24 March 2009, National Treasury and SARS discussed the VAT 419 guide[8] with Municipal Finance employees. In following, a similar approach should have been followed to communicate the changes in legislation in respect of section 12(*h*) to the education industry as a whole in ensuring a clear transition was made. As a result, due to the lack in communication of the change in policy, private FETs who were registered under the FET Act and now fell within the VAT exemption under section 12(*h*) were not aware of this major impact on their taxable activities and continued to charge VAT at the standard rate and claim the respective input tax deductions. This in turn has created a VAT exposure for these institutions. (Silver & Beneke 2015)

The disallowance of input tax deductions by SARS would severely impact a significant amount of FETs in the industry. These FETs would not be able to recover the VAT incorrectly charged to business and individuals. Despite reference being made specifically to private FETs, the above-mentioned changes in policies may have created a similar issue amongst Private Higher Education Institutions as well (Lomofsky & Lazarus 2001).

[7] Regulation 270 (28 March 2007) Government Gazette No. 29741 - Transitional arrangements for municipalities following the deletion of paragraph (*c*) of the definition of 'enterprise' in section 1, the zero-rating of municipal rates and other consequential amendments.
[8] The SARS VAT 419 – Guide for Municipalities (SARS, 2013d).

**Primary vs Tertiary Education**

Education in its general sense is a form of learning in which the knowledge, skills, values, beliefs and habits of a group of people are transferred from one generation to the next through storytelling, discussion, teaching, training, and or research. Education is formally divided into stages such as preschool, primary school, secondary school and then college, university or apprenticeship. South Africa's National Qualifications Framework recognises three broad bands of education, namely the General Education and Training band, the Further Education and Training band and the Higher Education and Training band. (Lomofsky & Lazarus 2001)

Primary education consists of the first 5–7 years of formal, structured education. School life spans between 13 years or grades, starting from grade 0, otherwise known as grade R or the reception year, through to grade 12 or the year of matriculation. General education and training ranges from grade 0 to grade 9. In terms of the SA Schools Act, education is compulsory for all South Africans from age 7 (grade 1) to age 15, or the completion of grade 9.

Tertiary education is the educational level following the completion of a school providing a secondary education. Tertiary education includes universities as well as institutions that teach specific capacities of higher learning such as colleges, technical training institutes, community colleges, nursing schools, research laboratories, centres of excellence, and distance learning centres. Tertiary education is taken to include both undergraduate and postgraduate education which incorporates both higher and vocational education and training. (Lomofsky & Lazarus 2001)

Cost considerations

Tertiary institutions differ in comparison to primary institutions in terms of the purposes they serve, ranging from both occupational programs to academics and research. These programs provide access to a higher level of education with a vast degree of possibilities that serve multiple functions (Carelse 2015). As these academic programs constitute a higher degree of learning, the costs associated in relation cannot be equated and paralleled to that of primary education. Thus

these additional costs should not be pooled collectively but segregated in terms of complexity and degree of value add (Altbach & Knight 2007).

As the objective of these higher education facilities embodies the essential skills and objectives that enable students to carry out a profession, which are over and above the services tendered at a primary level (Carelse 2015); these educational services should be zero rated and excluded from the standard exemption, as a consequence allowing for the recovery of the VAT paid. Additional costs that are relevant at a tertiary level include those costs attributed to research. These costs are often significant and are funded predominantly through research project and programme grants. As the bulk of the grant received is perceived as exempt, the institution forgoes the right to claim the input tax on these research associated costs. This may in turn prove to be in conflict with the original aim of providing such funds where the researcher is not allowed to recover the VAT. In addition, research funding provided from offshore donors normally have a firm directive in that no funds received may be expended to the State in the form of taxes. Such contributions are granted for the benefit of the study and is regulated to maintain that aim. The implications of subjecting such funds to the 'trapped VAT', ultimately constitutes a breach of contract between the institution and the offshore third party. This could have a direct negative effect on such future contributions. (Silver & Beneke 2015)

Conclusion

Although higher education institutes may be funded to some degree through the government (state owned to a larger extent as opposed to private), they also generate income independently (Alderman & Del Ninno 1999). Such 'private fund' income should be allocated separately and remain unconnected to the standard funds. As these private funds would in the main be funded by the institution, costs associated with producing these additional private services would as a result be incurred (Lomofsky & Lazarus 2001). These additional services that are considered over and above the primary norm should be treated in the form of a separate class of educational services and accounted for under a special predetermined rate (Silver & Beneke 2015) Furthermore, as previously outlined, as primary education is distinguishable from tertiary education, separate consideration in terms of operations, associated costs and the degree of

complexity should be reviewed and given regard before applying a standardized VAT treatment to encompass both (Carelse 2015).

## CHAPTER 4 – BACKGROUND AND INTENTION OF PROVISION

For purposes of assessing 'educational services' and the VAT treatment relating thereto, it is crucial to examine and understand the background relating to the current VAT treatment of 'educational services'. Moreover, the intention of the legislation is of paramount importance in terms of the aim such policy was intended to achieve (Pfeiffer & Ursprung-Steindl 2015).

The Draft VAT Bill of 1991, provided that primary, secondary and tertiary educational services provided by the State and certain institutions would be exempt from VAT. According to the VATCOM[9], the decision to exempt educational services was motivated by the importance of education in South Africa, and the fact that the cost of providing these services to a greater extent would be financed by the State. To this extent it was stated that:

> [a]ny increase in the costs of these institutions will be financed by increased contributions by the State and there will be no net gain to the State if they are subject to tax. It will in the main merely increase the administrative burden of these institutions.

Both arguments constituted the main and sole reason for exempting educational services. With regard to the latter statement it was further argued, that if educational services were to be subject to VAT then some 21 000 educational institutions in South Africa would have to account for VAT and submit VAT returns.

The exemption of education from VAT was further attributed to the fact that educational institutions within South Africa provide an essential service to the country and that no additional burden should be placed on students who receive any educational service as listed in section 12 (*h*) of the VAT act.

[9] The VATCOM released a comprehensive report on 19 February 1991

The committee had, in addition, given regard to the subject of zero rating as opposed to the exemption and were of the opinion that the zero rating of education would have little to no effect on the fiscus of the country as majority of the educational institutions receive funding or assistance from the state. Furthermore, the committee were in favour of the exemption as it would significantly alleviate the institutions' administrative burden and would not require the institution to register for VAT.

Pre-primary educational centres requested the zero rating as they were not primarily funded by way of subsidies. VATCOM declined this request stating the basic philosophy that assistance to deserving causes should be provided outside the tax system. However, as a result of the current wording of the section and the evolution of the educational service providers the VAT is trapped and passed onto the student, who is the ultimate beneficiary or final consumer of the tax burden. In this context, zero rating would prove to be more beneficial. (Pfeiffer & Ursprung-Steindl 2015)

The above may be summarised as follows:

> While the VATCOM acknowledges the important service provided by these centres, in keeping with the basic philosophy that assistance to deserving causes should be provided outside the tax system, it cannot support zero-rating for these services.[10]

Zero rating of all educational institutions would place them in a better position than they presently are and reduce the VAT compliance cost. The reason for the initial exemption was to eliminate the VAT compliance cost and burden to these institutions. This benefit no longer exists.

There was room for concern that private and commercial schools would be excluded from the exemption as a result of the wording 'of a public character' in the exemption. However, the wording was made to imply the inclusion of the public and private sector and hence private and commercial schools would qualify for the exemption. Similar to pre-primary education this

[10] The relevant extract from the VATCOM is provided as Annexure 1.

originally was to ensure that all schools received the same treatment i.e., a standardized treatment.

While taxing educational institutions was viewed as merely increasing the administrative burden on such institutions this did not prevent these institutions from registering. Institutions receiving income from sources other than education may still have to register for VAT (e.g. if the institute receives income from regular fundraising events, etc.). This not only resulted in a VAT registration liability but complex apportionment ratio problems. As such, the administrative burden was not reduced but substantially increased in many cases.

Conclusion

It is important to note the comments highlighted above, which demonstrate the two reasons for exempting educational services. It should be noted that these are in most cases no longer satisfied. The objective of extending the exemption to pre-primary education was to ensure that such education was treated the same as the other categories of education and not for purposes of granting some form of benefit, subsidy or a means of wealth distribution. When the objection and intention of the legislation is no longer satisfied, the legislation must be reassessed and the treatment relating thereto re-examined.

The objectives in terms of Education from a Government perspective should also be noted for purposes of this analysis which may be summarised as follows, firstly, in terms of the South African Schools Act where it is imperative to ensure all learners have the right of access to quality education without discrimination. And secondly, the higher education strategic goals which include increasing the number of skilled youth by expanding the required access to education to all which is critical to achieving economic growth. (Feria & Krever 2013)

## CHAPTER 5 – ISSUES OR DIFFICULTIES IN RESPECT OF THE CURRENT PROVISION

This chapter will examine the difficulties and challenges encountered by the education sector as a result of the current section 12(*h*) provision in relation to the VAT exemption on educational services and will provide arguments to warrant proposed changes in respect of the VAT treatment thereon.

The current reality is that the increasing cost of education is resulting in many educational institutions conducting fund raising activities or having to supply other taxable supplies, for example, the sale of books etcetera, all of which fall outside the current exemption and thus such institutions are often required to register for VAT. This is primarily the case of private institutions and universities, but not necessarily limited thereto as public institutions, which are government subsidized, may also carry on fundraising activities, etcetera. (Owen *et al,* 2011)

Consequently, these institutions have to apportion the VAT that cannot be wholly attributed to either taxable or exempt supplies. Often the institutions are not equipped to handle this fairly complex piece of legislation (Englisch 2011). In addition, these institutions do not have the necessary available resources and software required to compute and evaluate such ratios, which in turn increases the risk for error and incorrect implementation (Keen & Smith 2007). Institutions also do not have the budget to pay for professional fees where this function is outsourced to third parties (Keen & Smith 2007). In fact, in paying professional fees to third parties to assist with their VAT compliance, these institutions are effectively spending money that should have been used for the intended purpose being education (Afenyadu *et al,* 2001).

The recent VCR in terms of the VAT apportionment methodology to be applied by Universities has created a number of complexities. The VCR sets out the apportionment formula these organisations need to adhere to, where the VAT cannot be directly attributed to either taxable or non-taxable supplies. The VCR is applicable to all public universities and universities of

technology in South Africa which are members of HESA. The formula proposed, as well as previous proposed formulae, is highly complex. In addition, new apportionment ratio calculations often require change in use adjustments which entails additional complexities. The additional costs of implementing these apportionment ratio calculations, would need to be factored into budgets going forward, eroding the funds that should have been used for the further advancement and development of education (Carelse 2015).

Furthermore the apportionment ratio calculation leaves room for manipulation and error. The above demonstrates that the initial intention of the VATCOM, i.e. maintaining the least amount of administrative burden and keeping the VAT system simple in respect of the education sector, is no longer met (Pfeiffer & Ursprung-Steindl 2015).

**Benefits of the exemption**

Tuan Minh Le (2003) submitted, the exemptions are seen as a practical way of meeting the distributional objectives of the State.

If reference is, however made to International commentary on the matter (e.g. IMF, OECD, etc.) the opposing view is submitted and supported in this regard. That is, distributional objectives would be better achieved if such activities were fully taxed and 'transfer' of equity was achieved through increased subsidies as exemptions does not allow for 'full' relief due to the fact that input tax deductions are denied (Ebrill *et al,* 2001). Furthermore, exemptions concern items of societal value with education being one them. The reason for exemptions is to increase consumption as a result of the concession granted. This in turn can only hold true if there would be a decrease of consumption should such services be fully taxed. Should this be the case, it can then be satisfied as benefit arising due to the exempting (Alderman & Del Ninno 1999).

**Disadvantages of the exemption**

The below disadvantages include issues or negatives aspects which impact the 'benefits' highlighted for such exemption.

An exemption from VAT does not totally absolve the goods or services from the impact of VAT, as the supplier of the goods or services cannot deduct the VAT incurred on goods or services acquired to make the exempt supply as input tax (Alderman & Del Ninno 1999).

Outsourcing, which is a huge part of the private education industry, is not encouraged as VAT is non-recoverable and this can lead to inefficiencies (Keen & Smith 2007). In other words, the administrative and financial functions in respect of educational institutions may be more efficient if outsourced. However, these are normally handled internally due to the VAT leakage which arises when institutions opt to outsource such functions (Keen & Smith 2007). This may, however, arguably be more of an issue for private and semi-private educational institutes than fully government subsidised institutes, but is nevertheless a disadvantage in respect of exempting educational activities (Western *et al* 1998). Outsourcing such functions may allow for more efficient and cost effective operations and, therefore, possibly larger funds available for, e.g. bursaries. In addition, these private institutions outsource the majority of their training, incurring VAT inclusive costs. These cannot be claimed leading to inefficiencies and higher education costs (Charlet & Owens 2010).

The exemption of supplies gives rise to extensive interpretation difficulties in relation to misclassification and classification disputes, in terms of what constitutes education and, therefore, the supply thereof. Whereby such misclassification and disputes lead to the incorrect VAT output treatment as well as input determination issues and complexities. (Alderman & Del Ninno 1999)

In addition to the above, exemptions lead to increased compliance costs, due to the requirements that arise when calculating ratios in entities that make both taxable and exempt supplies (Botes & De Wet 2006). One of the supporting reasons for the exemption of education, as provided in the VATCOM, was that it would reduce the administrative burden for educational institutes (Botes & De Wet 2006). Yet, the opposite effect was yielded for educational institutions make both taxable and exempt supplies as these institutions now have substantially increased administrative costs in order to apply the mandatory apportionment ratios in determining permissible input tax deductions (Bird & Gendron 2006). Furthermore, due to its

technical and complex nature it may not be uncommon to find educational institutes that are not aware of the technical requirements they face (Carelse 2015).

In respect of educational institutes which have both taxable and exempt income and, therefore, apportionment requirements, there is an increased risk for business as a result of the misclassification of supplies, the incorrect direct attribution and apportionment calculations, etc., which may lead to an understatement of output tax or the overstatement of input tax deductions. The aforementioned risks may result in a tax liability, penalties and interest for educational institutions for no justifiable reason but which may be primarily attributed to the complexities of applying the exemption correctly. (Keen & Smith 2007)

There is a common misconception that the exemption of education is an effective transfer system to low-income households. The Modern VAT (Ebrill *et al,* 2001) in contrast highlights, that the exemption of education levels the playing field between publicly and privately provided educations where public education is subsidized. It is nevertheless important, however not to discriminate between either forms of education and exemptions are not an efficient way of implementing a transfer system. To this extent it is important to reiterate that the VATCOM clearly provided that pre-primary education was to be exempt to ensure consistent tax treatment and not for purposes of subsidy or wealth distribution, as the VAT legislation was not intended to be used in this manner (Millar 2015). The intention was not to have a subsidising effect but to have the value add as tax free, in spite of this, the non-claimable input tax has effectively been passed on; i.e. there is an embedded tax included in the cost (De Koker & Kruger 2008). Ultimately the trapped VAT that is non-recoverable as a result of the nature of the supply is shifted to the student.

A further consideration is the substantial salary costs attributed to private and semi-subsidized education on which no VAT is levied (Silver & Beneke 2015). Thus, by taxing education, either at the standard rate or zero rate, will in essence provide for the VAT input tax deductions on limited costs incurred by the institute (Alderman & Del Ninno 1999). Thus, the input tax deduction which is trapped due to the exemption is low in comparison to the overall costs incurred by the institute. In addition, if the concern is that profit making institutes will benefit in this regard, a limitation

may be added allowing education institutions which effectively qualify as and are registered Public Benefit Organisations ('PBO's') in terms of section 10(1)(*c*N), read with Schedule Nine of the Income Tax Act, No 58 of 1952 ('the ITA') to be zero rated and all others to be standard rated. Alternatively, educational institutions should be removed from the exemption category and the 'welfare organisation' constraints extended to specifically include those institutes providing education devoid of profit (Silver & Beneke 2015) (Refer to the following chapter for the discussion regarding 'welfare organisations').

An additional belief is that the exemption offers a mechanism for the redistribution of wealth and in reducing the regressive effects of VAT, all of which are not true as it merely acknowledges certain expenditure but does not indicate taxpaying capacity (Ebrill *et al,* 2001). Foreign commentary on the matter is in support of this view wherein it is highlighted that an exemption does not allow for transfers and redistribution as desired. The objective of redistribution is only achieved if the exemption predominantly benefits low-income earners or the poor who spend more in comparison to the wealthy. Therefore, if low-income households do not spend high amounts on public education, this would not hold true. If the intention of the exemption has changed over the past 20 years, whereby the exemption is for wealth distribution, then this objective is not being achieved. (Pfeiffer & Ursprung-Steindl 2015)

'Transfer systems', achieved through VAT exemptions as opposed to subsidies or grants, also increase the administration and compliance costs as interpretational problems and misclassification issues arise and often there is abuse, for the reason that the intended recipients do not benefit. Transfer systems may be best achieved through the direct subsidies provided to government schools. In essence, educational institutions should not spend the money currently expended on compliance with complex apportionment ratio determinations but rather utilize such funds in the furtherance of education. (Silver & Beneke 2015)

**Alleviation of the Administration Burden**

In terms of the *SARS VAT 404 Guide for Vendors*, (SARS, 2015a) ('SARS VAT 404 Guide') the biggest change with respect to VAT compliance has been the move from a paper-based system to that

of electronic filing of VAT returns. The introduction of electronic systems for filing and paying taxes has been shown to significantly reduce the tax burden on institutions and businesses as it reduces the amount of paperwork associated with doing taxes and lowers the cost of administration.

The guide makes note of the new features SARS has added over the years in improving the capability and functionality of the eFiling system. Some of the current features include the ability to amend a VAT return subsequent to its submission, the requesting of a statement of account, VAT vendor search, requesting of a tax clearance certificate, payment of Custom's duty and VAT, obtaining a history of eFiling return submissions and payments, various payment options including credit push, debit pull and ad-hoc payments and the ability to allocate and re-allocate payments to different tax periods. The system has time saving advantages for both SARS and the taxpayer and significantly reduces the administration burden of compliance.

Conclusion

All in all, the disadvantages far outweigh the benefits in relation to the VAT exemption on educational services (Botes & De Wet 2006). In addition, wholly subsidized government schools, unless such schools have other taxable income, would in most instances not satisfy the compulsory registration requirements and would therefore not be required to register for VAT purposes. Thus the removal of the exemption should not result in an adverse administrative burden for government schools. In this regard, should National Treasury not be in agreement with this view, economical and empirical studies should be performed in determining the financial impact in respect of the administrative burden arising from the removal of the educational institute exemption. (Silver & Beneke 2015)

## CHAPTER 6 – THE WELFARE ORGANISATION CONCESSION

The purpose of this chapter is to highlight the benefits bestowed on the welfare organisation concession for VAT purposes and will aid to demonstrate the positive impact that will be created should educational services be included in the same ambit.

### PBO Recognition in terms of the VAT Act

In terms of *SARS VAT 414 Guide for Associations not for Gain and Welfare Organisations* (SARS 2016b) ('SARS VAT 414 Guide'), limited and specific PBO's are referred to as welfare organisations in terms of the VAT Act. In order to qualify as a welfare organisation for VAT purposes, the organisation must be a PBO as contemplated in paragraph (*a*) of the definition of 'public benefit organisation' in section 30(1) of the ITA[11], which has been approved by the Commissioner under section 30(3) of the ITA[12] and which carries on a welfare activity listed in terms of the Regulations – The Government Gazette 27235 (dated 11 February 2005).

In order to qualify as a welfare organisation for VAT purposes, the 'public benefit organisation' must carry on any of the following welfare activities[13], as determined by the Minister of Finance in terms of Regulation No 112 of 2005[14] under the following headings:

- Welfare and humanitarian;
- Health care;

[11] If a PBO is dissolved it must transfer its assets to a similar PBO which has been approved in terms of section 30 of the Income Tax Act No. 58 of 1962 or to any other similar institution, board or body which is exempt from tax under the provisions of section 10(1)(*c*A)(i) of the Income Tax Act No. 58 of 1962. The similar institution sole or principal object must be the carrying on of any public benefit activity or to any department of state or administration in the national, provincial or local sphere of government in South Africa.

[12] Section 10(1)(*c*N) of the Income Tax Act No. 58 of 1962 exempts from income tax, receipts and accruals of any PBO approved by the Commissioner in terms of section 30(3) of the Income Tax Act, No 58 of 1952.
Section 30(1) of the Income Tax Act, No 58 of 1952, defines a PBO as either a company formed and incorporated under section 1 of the Companies Act No. 71 of 2008, a trust or an association of persons.

[13] The list of activities classified as welfare activities is attached herewith as Annexure 3.

[14] Published as Government Notice No. 112 in the Government Gazette No. 27235 on 11 February 2005.

- Land and housing;
- Education and development; or
- Conservation, environment and animal welfare.

Although this list of activities is at its source in accordance with the list of activities as prescribed in the Ninth Schedule to the ITA[15], it is a lot more restrictive as it excludes activities that would generally be exempt for VAT purposes. Therefore, a PBO will not automatically qualify as a 'welfare organisation' for VAT purposes as this will be dependent on whether the institution conducts any of the listed welfare activities for VAT purposes and such activity is not specifically exempt for VAT purposes. Therefore, to the extent that a PBO carries on activities involving the supply of educational services, which are exempt from VAT, it will not qualify as a welfare organisation and will not be able to register for VAT.

The SARS VAT 414 Guide, further provides that a welfare organisation is not required to supply goods or services for a consideration in order for it to be regarded as an enterprise for VAT purposes, as such activity is not specifically exempt for VAT purposes. In other words, it does not have to receive payment for goods or services supplied to qualify as an enterprise and to be allowed to register for VAT. Therefore, a welfare organisation may register voluntarily and will be allowed to claim input tax. In addition a welfare organisation is not precluded from conducting trading activities, at which the normal standard rate would apply.

In terms of Regulation No. 112[16] the welfare activities relating to 'Education and Development' extends to the following:

> (*a*) The provision of school buildings or equipment for public schools and educational institutions engaged in exempt activities contemplated in section 12(*h*) of the Value-Added Tax Act, 1991, for the benefit of the poor and needy and physically disabled.
>
> (*b*) Career guidance and counselling services provided to persons for purposes of attending any school or higher education institution as envisaged in section 12(*h*)(i)(*aa*) and (*bb*) of the Value-Added Tax Act, 1991.

[15] Organisations wanting to benefit from the tax exemptions granted in terms of the Income Tax Act need to obtain approval from the South African Revenue Service.

[16] Published as Government Notice No. 112 in the Government Gazette No. 27235 on 11 February 2005.

(*c*) Programmes addressing life skill needs of children at schools, pre-schools or educational institutions as envisaged in section 12(*h*) of the Value-Added Tax Act, 1991.

(*d*) Educational enrichment, academic support, supplementary tuition or outreach programmes for the poor and needy.

(*e*) Training for unemployed persons with the purpose of enabling them to obtain employment.

**Special Benefits**

In terms of the SARS VAT 414 Guide, a welfare organisation for VAT purposes encompasses all the benefits bestowed to an association not for gain, and over and above, is also entitled to register for VAT purposes, albeit the fact that the organisation does not assume any charges of consideration for services supplied. Generally input tax is denied to vendors in respect to goods and services acquired for the purpose of supplying entertainment unless it is their business to do so. Special concession, however is granted to welfare organisations in that they are allowed to deduct such entertainment expenses which are integral to the carrying on of a welfare activity. As a consequence the provision of food and accommodation by welfare organisations to underprivileged children would be permitted as a deduction, whereby for other organisations is subsequently denied.

**Designated entity & Grants as defined**

A welfare organisation is a 'designated entity' as defined in section 1(1) of the VAT Act.

The SARS VAT 414 Guide, states that the 'designated entity' class extends to welfare organisations. Designated entities essentially carry out work which would otherwise be done by government, but compete with other vendors in the economy. The funding these organisations receive is treated on the same basis as the consideration received by other vendors for making the same or similar taxable supplies. Payments to designated entities are therefore taxable at the standard rate of 14%. This means that grants received by designated entities will attract VAT at the standard rate. Education institutions that are predominantly State funded who do not conduct activities of a commercial nature and who do not compete with business will never be

required to register as they will not be considered to be carrying on an enterprise for VAT purposes (Silver & Beneke 2015).

**Section 11(2)(*n*) – Zero rating Exemption**

Where a welfare organisation is a vendor and receives a grant for the purposes of making taxable supplies to other persons, that vendor is deemed in terms of section 8(5) of the VAT Act, to supply a service to the person making the payment (e.g. the State).

Section 11(2)(n), however provides for an exception to the rule, should the grant recipient be a welfare organisation and the grant funds are used for carrying on welfare activities. This deemed supply of a service is subject to VAT at the zero rate[17] and, therefore, no output tax is payable[18] on the grant or subsidy received. By design, a welfare organisation conducts an enterprise for VAT purposes merely by carrying on certain 'welfare activities' listed in Government Notice No. 112 (dated 11 February 2005). (De Koker & Kruger 2008)

Conclusion

The above considerations have been provided to demonstrate and highlight that the VAT Act, in principle, already caters for and provides benefits in certain circumstances. Thus, to the extent any recommendations herein encompass special privileges or advantages, such privileges and advantages do not constitute a new concept in the VAT Act, nor do they exceed existing principles already contained therein. Furthermore, to a certain degree the VAT Act already sufficiently caters for educational institutions without requiring substantial changes to the current legislation. (Feria & Krever 2013)

[17] A zero rated supply is a taxable supply which is taxed at the zero rate (i.e. 0%). Accordingly no output tax is charged, but as the supply is a taxable supply, the vendor obtains a full input tax deduction for the tax payable by him on all goods and services acquired and utilised in generating the supply.

[18] Where the supply of a good or service is zero rated, the underlying economic activity is effectively excluded from the VAT base (tax base). The underlying economic activity in the case of exempt supplies is only partially excluded from the VAT base.

In addition, it is evident that the framework already exists for a means in which to administer and govern such entities. Should there be a concern towards the potential abuse of the VAT system, a limitation could be formulated to permit the zero rating to those institutes only, whom upon dissolution are required to transfer their assets to another institute carrying on similar activities (i.e. limit the zero rating to educational institutions which qualify as PBO's). Therefore supplies by all remaining institutions not sanctioned as PBO's by the State would then be subject to the standard rate. (Botes & De Wet 2006)

Moreover, the addition of such limitation is again not a new concept in the VAT Act as evidenced by, first, the inclusion of 'welfare organisations' and, secondly, the limitation that such provision does not apply to exempt supplies. By extending welfare activities to include the supply of education, as provided for in Part II of the Ninth Schedule to the ITA which sets out the qualifying PBO activities, educational institutions who previously could not register for VAT may voluntarily elect to do so in terms of the 'welfare organisation' VAT rules and will be allowed to claim input tax. In addition, this would effectively be an 'election' and, therefore, educational institutions that believe the administrative burden will be too great to warrant the registration will not be required to register unless they carry on taxable activities which exceed R1million in a 12 month period. This is in line with the initial intention of the legislation. (Alderman & Del Ninno 1999)

In summary, the primary importance with regard to the above aforementioned analysis and comments is to take cognisance of the fact that the VAT Act in principle allows for special benefits to certain organisations. To the extent educational institutions are deleted as an exempt supply and 'welfare organisation' provisions expanded, this will not result in a new provision, rule or benefit being formulated in terms of the VAT Act[19].

[19] By extending welfare activities to include the supply of education, education institutes who previously could not register for VAT may voluntarily elect to do and will be allowed to claim input tax. Furthermore the apprehension towards the administration burden overshadowing the benefit derived, should not be the primary concern as many institutes are required to register as they are generating other taxable supplies.

## CHAPTER 7 – INTERNATIONAL PRACTICE IN RESPECT OF THE VAT TREATMENT OF EDUCATIONAL SERVICES

The purpose of this chapter will be to examine and compare the legislative and administrative approaches with respect to educational services as adopted by other countries and international organisations in comparison to the methodology embraced in South Africa. In addition, this chapter will highlight the differences in approach, establish reasons and draw conclusions on any variances.

The Organization for Economic Co-operation and Development ('OECD') is a unique forum where the governments of 34 democracies with market economies work together, as well as with more than 70 non-member economies to promote economic growth, prosperity, and sustainable development. SA is currently not a member of the OECD but has a 'working relationship' with the OECD, participates in a variety of OECD events and has entered into an enhanced engagement programme with the OECD and as such, South Africa follows OECD guidelines. (Charlet & Owens 2010)

As South Africa follows the OECD guidelines, the OECD in this regard is relevant to the analysis.

Exemptions have been candidly described as constituting 'an alien matter within the tax system. They raise concerns regarding both, optimal tax policy and constitutional requirements of the tax system' (Englisch, 2011). VAT policies implemented should adhere to the OECD principles of

'neutrality'. To this extent, VAT exemptions are viewed as effectively contravening such 'neutrality':

> According to modern theory of public finance, a key requirement for a good tax system is that it should ideally not interfere with the efficient allocation of resources… There is a common belief among economists that considering information asymmetries and the reality of political decision making, '…best practice… strongly indicates that the consumption base of the VAT should be defined as broadly as possible and that all goods and services should be taxed at a uniform rate' in order to promote fiscal neutrality… By contrast, exemptions are hardly ever fully neutral with respect to competing goods or services. Moreover, the neutrality requirement extends also to the organisation of business activities…[20]

In addition to adhering to the OECD principle of 'neutrality', tax policies are also required to adhere to the OECD principle of 'simplicity and administrative efficiency'. A supporting argument for exempting 'education', as highlighted in the VATCOM, was that it would decrease the administrative burden on educational institutions which was viewed as an unnecessary burden when there would 'be no net gain to the State if they are subject to tax' (Ebrill *et al,* 2001). The opposite is in fact true as exemptions can actually increase the administrative burden of compliance and are not viewed as administratively efficient:

> A tax system should not cause disproportionate or even excessive costs for those affected, taking into account both, compliance costs of the taxpayer and administrative costs of the tax authorities… Since exemptions are by definition exceptions they add complexity to the tax system. In particular, they tend to give rise to difficult interpretive questions regarding the delimitation of their scope. The resulting increase in compliance costs and risks for business will also tend to reduce the benefits of the exemption for the taxpayer… [21]

The United Kingdom and other European Union states generally exempt education. With that being said. It should be noted that the VAT system on which they operate is a fairly traditional one in which exemptions are common, yet the modern and post-modern trends (on which South Africa is seen to operate) seem to be shifting towards reducing the number of exemptions in the VAT system. (Ebrill *et al,* 2001)

[20] Englisch, J., 2011. *EU Perspective on VAT Exemptions* (p13-14)
[21] Englisch, J., 2011. *EU Perspective on VAT Exemptions* (p14-15).

The exemption of education, or for that matter any exemptions offered for reasons other than technical reasons[22], is often viewed as a way to grant 'subsidies' in target areas or to targeted groups as the objective of exemptions is to reduce the tax burden on the final consumer (Bird and Gendron 2006). By exempting a supply, however, the supplier is not entitled to claim an input tax deduction in respect of any taxable goods or services acquired in the course or furtherance of making such exempt supplies (Ebrill *et al,* 2001). Thus, the 'subsidy' is effectively only granted on the last leg of the supply while VAT imposed on previous portions of the supply chain remain 'trapped' and, effectively, on-charged (Ebrill *et al,* 2001). To this extent, Micheal Keen (2007) provides the following comments in respect of there being no justification regarding 'equity-based' exemptions:

> In so far as an exemption can be regarded as legitimate and indeed required because the expenditure incurred for the exempt item or service by a final consumer typically does not indicate any taxpaying capacity, regardless of the amount spent, any form of 'input taxation' through a denial of a right to deduct input VAT is obviously inconsistent. Tax equity requires that goods and services the costs of which can clearly be identified as expenditure related to the minimum subsistence, even when considering the restrictions to such an approach in the context of VAT as an indirect tax, must not be made dearer by imposing a VAT burden. Relief for such expenditure that is typically incurred for indispensable items and services in order to serve essential human needs must be granted in full, excluding both, explicit and implicit VAT burdens. Hence, effective zero rating of the corresponding supplies would be appropriate**…** [Emphasis added].

Trevor Thomson (1974) further added that 'the VAT treatment of educational services in the EU may be primarily attributed to the EU's traditional VAT system which '...largely reflects their age, and the difficulty of removing privileges once given…' rather than any other economic, equity-based, neutral or efficient reasoning'.

New Zealand unlike the European Union states and the United Kingdom, follows a modern VAT system as opposed to the traditional VAT system and does not exempt education. The modern VAT system has a single VAT rate and a much lower VAT rate compared to European Union countries. The system has no concessional exemptions and no exclusions and has illustrated that services supplied by governmental institutions or public bodies can be included in the VAT

[22] An example of a technical exemption would be the exemption of financial services. Such exemption is not granted as a way to provide an equity-based subsidy but rather to overcome technical difficulties with taxing financial services.

system. The primary reason for taxing certain supplies such as educational services is that it levels the playing field between publically and privately provided educational services. (Giles 2000)

Furthermore, New Zealand, in contrast to the European Union states and the United Kingdom, is of the opinion that there is no merit to concessional exemptions, rejecting exemptions to subsidise particular activities (Giles 2000). The modern VAT system is a 'broad-base VAT with a low single standard rate, a low registration threshold, and few exceptions and exemptions' (Charlet *et al*, 2010). The fact that New Zealand scores the highest on the 'OECD VAT revenue ratio' may be indicative of the fact that New Zealand has implemented an administrative efficient and neutral VAT system, which is preferable to the European Union's traditional VAT system which applies several exemptions and reduced rates (Ebrill *et al,* 2001). As such, New Zealand does not exempt educational services as there is no justification for such exemption (Giles 2000).

It is important to note that the United Kingdom has different forms of VAT treatment to certain categories of education, dependent on the type of education supplied (e.g. business training courses subject to VAT at standard rated, state schools exempt, etc.). Thus, various avenues of relief are created without shifting the tax burden (Dickson & White 2008).

Further insight and commentary regarding the VAT treatment of education is provided by Ebrill ( Ebrill *et al,* 2001):

> Two features of the education sector are important to this question: it is a significant component of national income; and basic education services are commonly delivered at zero or subsidized prices, in competition, to some degree, with private producers.
>
> The last feature implies that to subject education to a VAT in the normal way would exacerbate the competitive distortion between private and publicly provided forms…

Therefore, in other words, the view held in accordance to the above, is that the primary purpose or argument for the favourable treatment of education is to create a level playing field between publicly and privately provided education where public education is subsidized. In other words, the argument is not for the transfer of equity to low-income households.

Further analysis in relation to exemptions, as supported by the OECD and the economists examined above, demonstrates that:

'…best practice… strongly indicates that the consumption base of the VAT should be defined as broadly as possible and that all goods and services should be taxed at a uniform rate' in order to promote fiscal neutrality… By contrast, exemptions are hardly every fully neutral with respect to competing goods or services.'[23]

Australia has extensive commentary and rulings in respect of educational institutions which may be of use and relevance within the current context, and provide further guidance relevant to South Africa. Australia has therefore been examined in further detail below.

[23] Englisch, J., 2011. *EU Perspective on VAT Exemptions* (p13)

**Case Study: Australia- Zero Rating of Educational Services**

The South African VAT system

VAT was introduced in South Africa in 1991 to replace Goods and Services Tax ('GST'). VAT is an indirect tax and is levied on the value added in production during the different stages of production. In South Africa VAT is levied on the supply of goods and services as well as the importation of any goods or services, while exported goods and services are exempted. However, VAT is generally seen as a consumption tax as the consumer pays it at the final stage of production. VAT was imposed in 1991 at a statutory rate of 10 % and was subsequently increased to 14 % in 1993. (Baker & Elliot 1997)

The South African VAT system is administered in terms of a rebate for intermediates and investment purchases. At the retail level, suppliers are charged the statutory VAT rate (currently 14% for all commodities except gold which is zero-rated so pays no VAT) and receive a refund for the tax revenue paid on intermediate inputs. The net payment is the statutory VAT rate applied to only the value added for that commodity. (Delfin *et al,* 2004)

GST and VAT are similar indirect taxes. In terms of the GST system, the tax is generally charged on the sale to the final consumer. Whilst, in contrast to a VAT system, where the tax is charged on each transaction in the production and distribution process. The range of goods and services subject to the VAT base is more extensive in comparison to the range of goods and services subject to the GST base. Though the range of transactions subject to VAT is wide-ranging than those subject to GST, the actual amount of tax borne is less. As observed by Mark Silver, 'VAT is essentially a tax on the expenditure in the domestic economy rather than a tax on the output of the domestic economy'. (Silver & Beneke 2015)

Design of the Australian Goods and Services Tax system

In designing a VAT system, a country must determine how broadly geographically it wishes to assert its tax authority (Ebrill *et al,* 2001). The State may elect to impose its VAT under a 'worldwide' or 'territorial' principle. Some prefer a modification of one while others to a larger

extent rely on a combination of both (Schenk 2009). In addition it can be argued that at present, no jurisdiction purely operates on a pure worldwide base or a pure territorial base system but are in reality operating on a combination of the two with significant elements originating from one, while being exercised by the other (Schenk 2009).

Australia encompasses a jurisdiction with a distinct Goods and Services Tax ('GST') system that operates on a unique set of supply rules. Commonly termed a 'territorial' GST State, the GST system limits the geographical scope to taxable supplies within the taxing jurisdiction, to just the place where the supply occurs. Thus the place of supply rules occupies a central role in the GST system. (Millar 2007)

South Africa in comparison functions on a worldwide tax system, whereby a vendor must report all supplies connected with his enterprise wherever they occur. In other words the imposition of tax does not depend on the place where the supply occurs. Although South Africa does not have distinct place of supply rules, once an entity carries on a sufficient level of activity to be considered as carrying on an enterprise in South Africa, all supplies made by that entity are deemed to be made in the Republic, irrespective of their actual location and generally without regard to the place of performance of the supply. (Silver & Beneke 2015)

The term 'enterprise' for South African VAT purposes as previously stated is described as:

> [a]ny enterprise or activity which is carried on continuously or regularly by any person in the Republic or partly in the Republic and in the course or furtherance of which goods or services are supplied to any other person for a consideration.

Rebecca Miller (cited in Lang *et al* 2009), is of the view that the very definition of the term enterprise is equivalent to the place of supply rules in South Africa. However Cecil Morden (cited in Lang *et al* 2009) is of the view that:

> '(t)he absence of explicit place of supply rules in the VAT Act leads to many frustrations in trying to establish exactly where the consumption of goods or services takes place.'

The above contradicting views further substantiates that a VAT system of one jurisdiction that is parallel in nature can modify the certain features of another juristic system to accommodate for their own, which best suits and caters to their own jurisdiction needs. In other words the similarities of one juristic system can work for another. (Lang *et al* 2009)

Australia imposes GST on taxable supplies by a registered person in the course of an enterprise conducted by the person, but to the extent such supplies are 'connected' in Australia. The supply will be considered 'connected with Australia' provided:

- 'The thing is done in Australia;
- The supply is made through an enterprise carried on in Australia; or
- The supply is of a right to acquire something that would be connected with Australia'.[24]

In addition to the above requirements that qualify as a supply subject to GST in Australia, the following conditions may also be considered a deemed supply:

- 'The recipient of the supply acquires the thing supplied solely or partly for the purpose of an enterprise that the recipient carries on in Australia, but not solely for a creditable purpose;
- The supply is for consideration;
- The recipient is registered, or required to be registered;
- The supply is not a taxable supply to the extent that it is GST-free or input taxed.'[25]

[24] Australian Taxation Office *Electronic Commerce Industry Partnership – Issue Register [ATO-eCommerce Issues] pg6.*
[25] *supra*

Furthermore the Australian GST legislation has incorporated subcategories of supplies referred to as 'supplies of anything else', which specifically include the supply of any services (Bird & Gendron 2006).

In South Africa in order to obtain personal jurisdiction to tax a person in terms of VAT, the person must meet two conditions, namely, the person is a resident or conducts an 'enterprise' in the country, and the person makes taxable supplies above the threshold amount (Lomofsky & Lazarus 2001). Once the personal jurisdiction is obtained the country has authority to tax all of the person's taxable supplies, without regard to the place where the supplies occur (Lang *et al* 2009).

Based on the above outline of the two VAT systems, it should be noted that although the Australian GST is recognized as being 'territorial', the system does demonstrate underlying traits which advocate 'worldwide' based operation (Bird & Gendron 2006). As mentioned above, the supplies have to be considered as connected to Australia before any tax is imposed on the registered person. To obtain personal jurisdiction over a person on the basis of the person's operation of an 'enterprise', the GST system largely relies on the 'permanent establishment' concept applied for income tax purposes (Lang *et al* 2009). The GST system includes distinctive rules that specify when goods and real property are considered connected and rules that specify how 'anything else', for example, in terms of services, is treated as connected (Lang *et al* 2009). These rules in totality have a direct link to the direction adopted by the worldwide structure. Therefore the Australian GST system operates at a closer link to the South African VAT system, although the view from the outset may seem different (Lomofsky & Lazarus 2001).

In addition, it should be noted, that reference to Australia is not within the context of the place of supply rules where, arguably, the greatest variances lie. Reference to Australia is specifically in respect of the educational services context and the principles applied thereto.

For purposes of demonstrating a recourse for the South African VAT system in adopting a zero rating approach in respect of educational services, as opposed to an exemption approach, the

laws adopted and applied in Australia relating thereto have been examined in greater detail, specifically in respect of the treatment and precedent that is similar to South Africa in this regard.

South Africa's political and economic objective with regard to education should also be borne in mind. It has been previously highlighted that South Africa's political objective with regard to education is to ensure all learners have the right to access quality education without discrimination and increasing the number of skilled youth by expanding access to education which is critical to achieving economic growth. Australia's similarity to South Africa in respect of economic and political treatment and objectives of education further support the specific reference made to Australia, with regard to the GST principles applied in this regard.

Economic consideration and State Objectives

The Australian government's objective and intention towards education has always been to promote a higher level of learning that enhances social inclusion and reduces social and economic disadvantage by providing access to higher levels of learning to people from all backgrounds (Schenk 2009). Thus improving education access to the general public and providing education to one and all. Special concessions are rendered towards individuals from low socio-economic backgrounds as primary objectives are enforced to provide low costing education that is affordable and easily accessible (Lomofsky & Lazarus 2001).

This is further demonstrated in the current Australian policy on equity in higher education, which is based on the national policy - A fair chance for all - (DEET, 1990). In terms of the Commonwealth of Australia, 2008b: 28[26], it was stated that:

> The overall objective for equity in higher education is to ensure that Australians from all groups in society have the opportunity to participate successfully in higher education. This will be achieved by changing the balance of the student population to reflect more closely the composition of society as a whole.

In addition, the policy highlights that it is the State's belief that social inclusion, which is the capacity for an individual to participate in key activities of the society, is closely associated to

[26] Commonwealth of Australia (2008) - Review of Australian higher education discussion paper, Canberra.

education. And with this being said the levels of engagement in society are all interlinked to levels of pay and employment.

The Australian government's focus towards education extends further than primary education as it is the belief that, a person with only a primary level education although less excluded than the illiterate and innumerate, still remains excluded from much employment and many other opportunities to participate in a modern industrialized society (Schenk 2009). Thus providing a level of higher education is vital to overall objectives in terms of nation building and regional development, whilst ensuring the proportionate participation of each segment of society in each segment and level of education (Altbach & Knight 2007).

McMillan and Durrington, (Cited in Western *et al*, 1998) are of the opinion that the role of the Australian government is encompassed into three basic principles. Firstly, to serve the needs of society and secondly, emphasis must be made towards promoting the good of the individual, i.e. in terms of enhancing quality of life or serving as an instrumental end towards employment and lastly all aims implemented must have a direct relation towards the good of society.

Qualifying educational services in Australia are GST free (zero rated), whereby the GST system provides for an allowance of recovery in the form of an input tax credit in respect of such services (Pearson 2009). The application of the law is restrictive in terms of determining which education suppliers would qualify for the GST-free treatment, as it is governed in terms of the definitions in the relevant Education Acts (Gendron 2009).The definitions are set out in section 195-1 of the Australian GST Act (i.e. A New Tax System - Goods and Services Tax Act of 1999) ('the Australian GST Act'). Due to the issues discussed around defining 'education institute' and the relevance relating thereto, full extracts are analysed hereunder:

**adult and community education course-** means a course of study or instruction that is likely to add to the employment related skills of people undertaking the course and:

> (*a*) is of a kind determined by the Education Minister to be an adult and community education course and is provided by, or on behalf of, a body:
>
> (i) that is a higher education institution; or
>
> (ii) that is recognised, by a State or Territory authority, as a provider of courses of a kind described in the determination; or

(iii) that is funded by a State or Territory on the basis that it is a provider of courses of a kind described in the determination; or

*(b)* is determined by the Education Minister to be an adult and community education course.

**education course** means:

*(a)* a pre-school course; or

(*b*) a primary course; or

(*c*) a secondary course; or

(*d*) a tertiary course; or

(*e*) a special education course; or

(*f*) an adult and community education course; or

(*g*) an English language course for overseas students; or

(*h*) a first aid or life saving course; or

*(i*) a professional or trade course; or

(*j*) a tertiary residential college course.

**government school** - means a school that:

(*a*) supplies any of these kinds of education courses:

(i) pre-school courses;

(ii) full-time primary courses;

(iii) full-time secondary courses;

(whether or not the school supplies any other education courses); and

(*b*) is conducted by or on behalf of an Australian government agency;

and includes a proposed school that will meet the requirements of paragraphs (*a*) and (*b*) once it starts operation.

**higher education institution -** means an entity that is a higher education provider as defined in section 16-1 of the Higher Education Support Act of 2003.

**non-government higher education institution -** means an institution that is not a higher education institution and that:

(*a*) is established as a non-government higher education institution under the law of a State or Territory; or

(*b*) is registered by a State or Territory higher education recognition authority.

**pre-school course** - means a course that is delivered:

(*a*) in accordance with a pre-school curriculum recognised by:

(i) the education authority of the State or Territory in which the course is delivered; or

(ii) a State or Territory body that has the responsibility for recognising pre-school curricula for courses delivered in that State or Territory; and

*(b)* by a school that is recognised as a pre-school under the law of the State or Territory.

**primary course**- means:

(*a*) a course of study or instruction that is delivered:

(i) in accordance with a primary curriculum recognised by the education authority of the State or Territory in which the course is delivered; and

(ii) by a school that is recognised as a primary school under the law of the State or Territory; or

(*b*) any other course of study or instruction that the Education Minister has determined is a primary course for the purposes of this Act.

**professional or trade course** - means a course leading to a qualification that is an essential prerequisite:

(*a*) for entry to a particular profession or trade in Australia; or

(*b*) to commence the practice of (but not to maintain the practice of) a profession or trade in Australia.

**school** - means an institution that supplies pre-school courses, primary courses, secondary courses or special education courses but not any other education course.

**secondary course -** means:

(*a*) a course of study or instruction that is a secondary course determined by the Education Minister under subsection 5D(1) of the Student Assistance Act 1973 for the purposes of that Act; or

(*b*) any other course of study or instruction that the Education Minister has determined is a secondary course for the purposes of this Act.

**tertiary course -** means:

(*a*) a course of study or instruction that is a tertiary course determined by the Education Minister under subsection 5D(1) of the Student Assistance Act 1973 for the purposes of that Act; or

(aa) a course of study or instruction accredited at Masters or Doctoral level and supplied by a higher education institution or a non-government higher education institution; or

*(c)* any other course of study or instruction that the Education Minister has determined is a tertiary course for the purposes of this Act.

**tertiary residential college course -** means a course supplied in connection with a tertiary course at premises that are used to provide accommodation to students undertaking tertiary courses.

**education supplies –** In certain circumstances, the following associated supplies are also GST-free:

- administrative services;
- lease or hire of curriculum related goods;
- course materials;
- rights to receive a GST-free education course;
- excursions or field trips; and
- student accommodation.

Differentiation made between services

It is evident from the above definitions that education and its fundamental factions is defined in the Australian GST system, and that the tax treatment employed follows suit with the types of education services supplied (Chrisholm *et al* 1990). The rate applicable is based on a test of whether the course is aimed primarily at developing occupational skills. If aimed at developing such skills, it will be zero-rated, however if the course is recreational, the fees will be taxable at the standard rate (Chrisholm *et al* 1990).

The term 'occupational' is not specifically defined (Western *et al* 1998), however it is construed to take on the meaning as outlined in The Macquarie Dictionary[27] as:

> 'Occupational means relating to a person's job or profession'

The term 'recreational' is also not specifically defined, however examples are illustrated in the forms of hobbies for example belly-dancing, which are activities of a recreational nature primarily enjoyed in one's spare time (Western *et al* 1998).

In order to ascertain whether an organization qualifies for the zero rating several aspects need to be considered, for example, identifying the entity supplying the education, the course's description and structure, the type of education course being supplied, the type of accreditation the entity has and its application to the education course supplied, how is the education course provided and any associated items that may be provided with the supply of the education (for example, items such as accommodation, course materials, excursions or meals) (Chrisholm *et al* 1990).

[27] Macquarie Dictionary 1997 3rd Edition Sydney.

The Professional Trade Distinction

The Australian GST Act provides special recognition for 'professional or trade course' as it is specifically included in the definition of 'education course' in terms of section 195-1, which includes a 'professional or trade course' as:

> [a] course leading to a qualification that is an essential prerequisite;
>
> (*a*) for entry to a particular profession or trade in Australia; or
> (*b*) to commence the practice of (but not to maintain the practice of) a profession or trade in Australia.

The term 'essential prerequisite' is defined in section 195-1 in the following terms:

> [a] qualification is an essential prerequisite in relation to the entry to, or the commencement of the practice of, a particular profession or trade if the qualification is imposed:
>
> (a) by or under an industrial instrument; or
>
> (b) if there is no industrial instrument for that profession or trade but there is a professional or trade association that has uniform national requirements relating to the entry to, or the commencement of the practice of, the profession or trade concerned - by that association.

The Australian GST Ruling GSTR 2003/01, provides a detailed explanation as to the meaning of a professional trade or course and what it encompasses. Furthermore consideration is given to extend the definition to courses that run through workplace training including apprenticeship, various educational institutions, professional or trade associations, and government and non-government bodies who supply education or training leading to qualifications for entry. The courses that are potentially covered by this Ruling range across diverse professions and trades, including trades relating to the licensed operation of various equipment or machinery.

As highlighted previously, one of the alternatives, the South African VAT system could encompass, should the zero rating treatment of educational services not be favourable, is that distinction be made between different classes of educational institutes and the method of VAT treatment applied, be aligned thereto (Silver & Beneke 2015).

In terms of the Australian jurisdiction it appears that an analysis is made in respect of the level and value add tertiary institutes offer in comparison to other institutes, as this distinction is made independently and included in the definition of 'education course' (McMillan & Western 2000). Tertiary institutes differ in comparison to primary institutes in terms of the purpose they serve, ranging from both occupational programs to academics and research. These programs provide access to a higher level of education with a vast degree of possibilities that serve multiple functions (McMillan & Western 2000). As these academic programs constitute a higher degree of learning, and prepare the learner for a specific trade, the costs associated in relation cannot be equated and paralleled to the same gradation as that of the primary education scale (Silver & Beneke 2015). Thus these additional costs should not be pooled collectively but segregated in terms of complexity and degree of value add (Silver & Beneke 2015). The Australian GST system, by providing such distinction in education and course class, provides ample relief for these higher level institutions and therefore mitigate the burden of excessive costs on the students (Chrisholm *et al* 1990).

Treatment of mixed supplies

The treatment of a supply that is partly taxable and partly GST-free or input taxed is the same as in South Africa and is referred to as mixed supply (McMillan & Western 2000). Paragraph 19 of the Goods and Services Tax Ruling GSTR 2001/8, provides that where a transaction comprises a bundle of features and acts, all the transaction's circumstances must be considered to ascertain its essential character. A mixed supply has separately identifiable parts that the GST Act treats as taxable and non-taxable, and these parts are not just integral, ancillary or incidental in relation to the whole supply. Whether a particular part is integral, ancillary or incidental in relation to the whole supply is a question of fact and degree (McMillan & Western 2000).

Meaning of 'directly related' to the supply of education

The term 'directly related' is not defined in the Australian GST Act and is considered to take on its ordinary meaning as defined in local dictionaries. The Macquarie Dictionary[28] defines 'directly'

[28] Macquarie Dictionary 1997 3rd Edition Sydney.

to mean 'in a direct line, way or manner; immediately; absolutely'. The term 'related' is extended to mean 'associated connected or allied by nature'. Therefore in order for services to be regarded as 'directly related' to the supply of an educational service and subject to the zero rate, that supply must be considered a direct line, immediately associated or connected with the supply of the education course (Chrisholm *et al* 1990).

The practice in terms of 'directly related or incidental' applied in the South African context is of a similar nature as detailed in the Australian GST Act, as in order for the goods or services relating to educational services to qualify for the exemption, they would need to be incidental and supplementary to the original supply (Silver & Beneke 2015).

GST Treatment of Tertiary Education

The Australian GST system specifically makes provision for the definition of tertiary education and the degree of courses it encompasses (Millar 2015). Tertiary courses includes all tertiary courses covered by the determination issued by the Education Minister under the Student Assistance Act 1973. This determination is also used to identify those courses that students must be undertaking to be eligible for income support as full-time students (Millar 2015). The eligibility of courses for the Student Assistance Act of 1973, is reviewed periodically by the Education Minister. In determining whether an education course is an approved tertiary course, it does not matter to whom the course is delivered as it will be GST-free regardless of whether it is delivered to resident students or non-resident students studying in Australia (Dickson & White 2008).

A tertiary course also includes a course of study or instruction accredited at Masters or Doctoral level and supplied by a higher education institution or a non-government higher education institution (Chrisholm *et al* 1990). Furthermore a distinction is made between private higher education and one that is governed by the State (Chrisholm *et al* 1990). In zero rating tertiary education, an effective recovery of costs is facilitated to compensate for the out of scope services these institutes supply in comparison to services delivered at a school level. Thus as mentioned above a differentiation is made and relief is granted (McMillan & Western 2000).

Treatment of Fees charged by Universities

Universities and educational institutions charge miscellaneous fees for various supplies. In order to determine whether a miscellaneous fee is subject to GST, the university has to identify which supplies are made to students in respect of the payment of fees (Dickson & White 2008). A fee will be GST-free if it is charged in respect of the provision of facilities and/or the supply of administrative services directly related to the supply of a GST-free education course (Millar 2015).Thus supplies that are incidental and concurrent with the main supply of education will also be subject to the treatment of zero rating (Millar 2015).

Conclusion

In summation as outlined above, it appears that the Australian GST system provides for a more beneficial form in terms of the governing of educational services (Chrisholm *et al* 1990). At the outset, the Australian GST system may seem distinctive in terms of regulation and the basis of their GST base, they are still a modern GST system with considerable traits in the direction of the worldwide position, which South Africa adopts (Millar 2015). The two States government's intention and objectives towards education are similar, in that the socio-economic needs of the underprivileged and the accessibility of education to the masses is uniform in terms of what both governments' are trying to achieve. As such, Australia provides valuable guidance on VAT principles and treatment which may and should be applied in respect of educational services.

## CHAPTER 8 – THE IMPACT OF E-COMMERCE VAT ON EDUCATION

This chapter will highlight the potential anomalies with the introduction of VAT on e-commerce transactions in South Africa (with effect from 1 April 2014) on exempt entities and suppliers of education that are unintentionally caught in the South African VAT net.

As previously outlined, the VAT Act requires any person conducting an enterprise in South Africa to register as a VAT vendor, provided certain requirements and the compulsory threshold is met (Silver & Beneke 2015). Previously e-commerce transactions were taxed in terms of a 'reverse charge mechanism,' (also referred to as VAT on 'imported services') where the onus was on the consumer to pay VAT on imported e-commerce goods and services (Betsie & Hare 2014). This system, however was proven practically unenforceable and the compliance levels thereon were low (Van Eeden 2013). Furthermore, local e-commerce suppliers were unable to compete with their foreign counterparts as they were forced to incorporate a 14% premium into their prices in order to account for the VAT charge (Betsie & Hare 2014). In an effort to address these issues, the VAT Act was amended, whereby suppliers of 'electronic services' to (a) South African residents, or (b) where payment for such services originated from a South African bank, were obligated to register as VAT vendors (Betsie & Hare 2014).

The Minister of Finance published draft regulations on the 30 January 2014 that provided clarification in terms of the particulars that would constitute as 'electronic services' (Wild 2014). The regulations list electronic services as including educational services, games and gambling, information system services, internet-based auction service facilities, maintenance services (in relation to, for example, a website or blog), subscription services (for example, online newspapers and magazines) and the supply of e-books, films and music (Betsie & Hare 2014). The regulations go on further and have included a wide variety of services that one would not ordinarily expect to be charged VAT. For example, the supply of any internet-based or multiplayer role-playing game has been specifically included (Van Eeden 2013). Furthermore, VAT could be charged on the numerous upgrades for games or other options available on Facebook and other

social networking services (Betsie & Hare 2014). Foreign e-commerce suppliers will be liable to register under the VAT Act at the end of any month in which the total value of its supplies of electronic services exceeds R50 000 (Wild 2014). Furthermore, the regulation has stated that there will be no distinction between business-to-business and business-to-consumer suppliers (Betsie & Hare 2014).

Educational institutions were previously in a better position and better sheltered under the reverse charge mechanism when it came to e-commerce services as there was arguably no VAT leakage when dealing with foreign suppliers in this regard (Van Eeden 2013).

Environmental concerns, technology advancements and access to information are all influencing dynamics to the way in which university students, in particular, embrace the digital libraries offered by the suppliers of higher education (Van Eeden 2013). Students are able to gain access to extensive amounts of information from electronic databases made available by universities that are sourced from foreign suppliers (Wild 2014). Moreover, international educational content may not always be available locally, and students wishing to continue their studies online will find themselves at the mercy of this new tax (Wild 2014). The concern raised is that the introduction of VAT on e-commerce and transactions could have a knock-on effect on the cost of education, as educational institutions would likely need to pass on the additional 14% VAT not previously budgeted for (Van Eeden 2013). As the suppliers of educational services generally make exempt supplies and the 14% standard rate of VAT charged by suppliers, represents a fixed cost which cannot be claimed back SARS as an input tax deduction (Betsie & Hare 2014). In other words, the introduction of such taxes means that vendors that will have to register to pay VAT, will essentially be pushing the price increases to the consumer (Wild 2014).

A further consideration is that in the current economic environment, it is already difficult for South Africans to access international academic journals (Wild 2014). The most prestigious, which contain the world's leading research, usually levy charges in dollars, pounds or euros for access to selected articles which in essence results in access made available to only the institutions that have the affordability to purchase and people with a means to such resources

(Van Eeden 2013). Such contributing factors fall foul of the previously highlighted intention of the VATCOM in exempting education wherein providing education that is affordable by all.

In general, educational institutions making exempt supplies to students were not required to pay VAT on imported services as reliance was placed in many instances (potentially incorrectly) on the exemption catered for in section 14(5)(c) of the VAT Act (Van Eeden 2013). The aforementioned section provided exemption from VAT on importation where there was a supply of an 'educational service' (undefined term) by an educational institution in an export country, which is regulated by an educational authority in that export country (Van Eeden 2013).

Conclusion

The proposed new tax regulations on e-resources together with the very unfavorable exchange rate, mean that, aside from students, even education institutions would struggle to purchase these journals (Betsie & Hare 2014). Although a number of national library and university organisations have requested for State intervention regarding this matter, no response or alternative means have been presented to date (Wild 2014). Laila Vahed (cited in Wild 2014), the chairperson of the South African National Library and Information Consortium stated, 'It will hit libraries at previously disadvantaged institutions the most, due to a lack of capacity to recover VAT and a dependency on library consortia deals where they rely on the participation of larger institutions to access material at an affordable, reduced price'. Dr Buhle Mbambo-Thata (cited in Wild 2014), who chairs the committee of higher education libraries based at the University of South Africa, stated that 'a number of groups responded, asking the treasury for an exemption for academic resources. However, they have not heard back'. She further added that, 'Most students depend on libraries to study and get their prescribed and recommended reading. If libraries cannot meet students' needs, it hampers their education. If the cost of e-resources goes up, it might in the end [result] in an increase in student fees'. As South Africa is shifting towards an open-access academic publishing initiative, with the Department of Science and Technology allocating R22-million to the Academy of Science of South Africa for the 2013-2016 period for the development of open-access journals, the reality is however, that it is the expensive journals where the world's best research is published, and the price tag for such resources is rising (Van

Eeden 2013). Many education institutions and eager for the State to address the potential anomalies created as a result of the introduction of the new tax in this regard and to exclude suppliers that were unintentionally caught in the South African VAT net. The education sector being one of them.

## CHAPTER 9 – APPORTIONMENT RATIO ANOMALIES

### General Rules of Apportionment

In terms of section 16(3) of the VAT Act and read in conjunction with the definition of 'input tax' (section 1) provides that a vendor may claim an input tax deduction in respect of any goods or services it acquires wholly in the course of making taxable supplies (Silver & Beneke 2015). Where the goods or services are acquired partly in the course of making taxable supplies, and partly in the course other than making taxable supplies, an input tax deduction may be claimed to the extent of the taxable usuage thereof (as determined in section 17 of the VAT Act) (Silver & Beneke 2015). In other words, the VAT rules require a vendor who makes both taxable supplies and supplies other than taxable supplies (for example loans earning interest) to claim input tax only to the extent that the goods or services concerned are acquired for consumption in making taxable supplies (Botes & De Wet 2003). Apportionment refers to the fact that only a portion of input tax that was paid is claimable and the portion not claimable will be added to the expense and will be deductible for income tax purposes when the enterprise is assessed for income tax (Botes & De Wet 2006).

In terms of Section 17(1) of the Act, input tax should be apportioned when the intended use of goods and services in the course of making taxable supplies is less than 95% of the total intended use of such goods and services[29] (Botes & De Wet 2006).

There are various methods of apportionment available to vendors of which the 'turnover-based' method is the only approved method by SARS for which no ruling is required (Silver & Beneke 2015). The sectors that are influenced the most by this provision are often the banks, universities and municipalities, as these sectors have large amounts of exempt supplies but also generate

[29] The Apportionment flow diagram is included as Annexure 6 herein.

taxable supplies with expenses incurred that cannot be allocated specifically to a certain income (Alderman & Del Ninno 1999).

**Various methods of apportionment**

The *SARS VAT 404 - Guide for Vendors* (SARS, 2015a) ('SARS VAT 404 Guide') provides the following examples of special apportionment methods which may be applied:

- turnover-based method;
- varied input-based method, based on the ratio of VAT wholly attributable to taxable supplies, to the total VAT incurred for all supplies, excluding VAT incurred for mixed purposes;
- floor space method;
- transaction-based method; and
- employee time method.

**Key Terms in the apportionment methodology**

**Enterprise:** The SARS VAT 404 Guide indicates that an enterprise is any business activity in the broadest sense. It includes any activity carried on –

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

Special inclusions

- Public authorities – certain government departments and provincial authorities.

- Municipalities – municipalities, Joint Services Board and Regional Services Council.
- Welfare organisations and Foreign Donor Funded Projects.
- Share block companies.
- Non-residents supplying certain electronic services where at least two of the following circumstances apply: Services are supplied to a South African resident, payment originates from the Republic of SA, or the recipient has an address (i.e. business, postal or residential) in the R Republic of SA

**Exempt supply**

The SARS VAT 404 Guide defines an exempt supply as a supply on which no VAT may be charged (even if the supplier is registered for VAT). Persons making only exempt supplies may not register for VAT and may not recover input tax on purchases to make exempt supplies. Section 12 contains a list of exempt supplies.

<u>Examples:</u>

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

**Input tax**

The SARS VAT 404 Guide defines input tax as the tax paid by the recipient to the supplier of goods or services. Input tax may only be deducted by the recipient vendor if the goods or services are acquired for making taxable supplies and if the vendor is in possession of a valid tax invoice for the supply. An apportionment of input tax must be made if goods or services are acquired only partly for making taxable supplies. In the case of an importation, the vendor must be in possession of a valid bill of entry and proof that the VAT has been paid to Customs. In certain instances, input tax may also be deducted on non-taxable supplies of second-hand goods acquired by the vendor, but the vendor must retain a proper record of the details of the transaction on form VAT 264. Should the second-hand goods acquired constitute fixed property, the transfer of which requires registration in a Deeds Registry, input tax may only be deducted once the property has been registered in the name of the vendor claiming a deduction.

The SARS VAT 404 - Guide for Vendors (SARS, 2015) further states that input tax may not be deducted on supplies of 'entertainment', motor cars and club subscriptions. Input tax may also not be deducted where goods or services are acquired for the purpose of making exempt supplies, for private use or for other non-taxable activities.

**Taxable supply**

The SARS VAT 404 Guide refers to a taxble supply as a supply (including a zero-rated supply) which is chargeable with tax under the VAT Act. A taxable supply does not include any exempt supply listed in section 12, even if supplied by a registered vendor. There are two types of taxable supplies, namely:

- Those which attract the zero rate (listed in section 11).

- Those on which the standard rate of 14% must be charged.

**Vendor**

The SARS VAT 404 Guide defines a vendor as any person who is registered or is required to be registered for VAT. However, where the Commissioner has determined the date from which a person is a vendor, a person shall be a vendor from that date.

**Association not for gain**

The SARS VAT 414 defines an association not for gain as any religious institution, society or organisation which is carried on, otherwise than for profit and in terms of its written constitution which governs it – is required to use any property or income solely in the furtherance of its aims; is prohibited to transfer any portion of property or income to any person, except as reasonable remuneration for services

provided; and is obliged, at its winding-up or liquidation to give or transfer its assets after satisfaction of debts, to another similar society.

It can also be an educational institution of a public character which – is carried on not for profit; is in terms of its memorandum which governs it required to use any property or income solely in the furtherance of its aims; and is prohibited to transfer any portion of property or income to any person, except as reasonable remuneration for services rendered.

Welfare organisations and PBO's are types of associations not for gain.

Botes and De Wet (2003) summarise the VAT implications of the various supplies generated in the table below:

| Table 1 | | |
|---|---|---|
| Types of Supplies | Amount of VAT claimable as input tax | VAT implications |
| Taxable supplies | Full amount of VAT incurred is input tax | Deduction under section 16(3), unless denied by section 17(2). |
| Exempt supplies | No input tax claimable | No deduction under section 16(3). |
| Other non-taxable supplies (e.g. s 8(14) | No input tax claimable | No deduction under section 16(3). |
| Private (non-business) purposes | No input tax claimable | No deduction under section 16(3). |
| Mixed use/purposes: taxable supplies AND exempt supplies, or private purposes | Input tax claimable to the extent taxable supplies are made | Input tax under section 16(3) may be deducted to the extent taxable supplies are made, unless deduction is denied under section 17(2). |

From the above it is indicative that the treatment of taxable and exempt supplies is a fairly easier exercise to perform in terms of determining the input tax claimable thereon as opposed to when a vendor engages in the yielding of mixed supplies, as the vendor is not entitled to the full input tax (Silver & Beneke 2015). Upon analysis, the question arises as to what portion of input tax is claimable and how should this be calculated. Guidance in terms of the manner in which the calculation should be performed and the resulting effect derived from the use of the various methods, is often limited (Botes & De Wet 2006). Furthermore, the onus is placed on the vendor to conform. De Koker and Kruger (Cited in De Koker & Kruger 2008) indicate that where mixed supplies are made, the vendor is clearly entitled to only a partial deduction of input tax, namely, on the portion that relates to his taxable supplies. For a vendor to determine an appropriate basis of apportionment in these circumstances may cause uncertainty and may be a complex exercise.

The starting point when claiming input tax is the application of the de minimus rule (Silver & Beneke 2015). De Koker and Kruger (2008) describe the de minimus rule as, 'once the proportion of taxable and non-taxable consumption or use of goods or services has been determined, the total amount of VAT incurred on the acquisition of the relevant goods or services must be apportioned between the making of taxable supplies and other supplies'.

In this regard, there are however expenses that cannot be directly linked to a taxable or to an exempt supply (Botes & De Wet 2006). In terms of section 17(1) proviso (i), the de minimus rule provides that, 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 of the goods or services, the goods or services concerned may be regarded as having been acquired wholly for the purpose of making taxable supplies. Therefore, in accordance with the provision, no apportionment needs to be applied by the vendor and the total amount of VAT payable is treated as input tax in the hands of the vendor concerned.

**The Direct – Attribution Method of Apportionment**

In terms of the SARS VAT 404 Guide, a vendor before attempting to apportion an expense, is required to first determine if the expense in question can be directly attributed. Direct attribution signifies that the vendor is required to attribute the VAT expense according to the intended purpose for which the goods or services acquired will be used. In other words, the direct-attribution method takes every transaction and attributes the input VAT to either taxable income or exempt income (Botes & De Wet 2006). In this regard, no input is claimable when the expense relates directly to an exempt income and the full input tax is claimable when the expense relates directly to a taxable supply.

The SARS VAT 404 Guide, further provides that where an expense cannot be directly linked and has been incurred partly for the purpose of consumption, use or supply in the course of making taxable supplies and partly for exempt and other non-taxable purposes, that the concerning VAT must be apportioned. The subsequent step is for the vendor to calculate the proportion of VAT

which may be deducted as input tax by applying the preferred apportionment ratio that is expressed as a percentage.

Although the VAT Act does not prescribe any method of apportionment and does not provide SARS with any discretionary powers in this regard, SARS prior to 29 June 1998, nevertheless specified two so-called standard methods of apportionment. The first being the input-base method and the second, the turnover-base method (Botes & De Wet 2006). SARS had further added that the method selected by the vendor must be applied consistently to all goods and services which were partially attributable to the making of taxable supplies and were in accordance to section 17(1) of the VAT Act. In following, a vendor would in addition be required to seek prior approval from SARS before adopting a different method of apportionment.

Post 29 June 1998, a vendor was required to adopt a method of apportionment prescribed by SARS in accordance with a ruling envisaged in section 41A or 41B of the VAT Act. Subsequently, thereafter SARS had prescribed one standard method of apportionment to be used with effect from 1 November 2000. The preferred prescribed method was the 'turnover-based' method of apportionment (Silver & Beneke 2015). The SARS VAT 404 Guide further provides , that where a vendor finds it challenging to apply the 'turnover-based' method of apportionment, the vendor may approach SARS requesting permission to use another method (for example, the input-based method). The onus is on the vendor to prove that it is a fair and reasonable approximation of the VAT that should be claimed. Furthermore, for an entity to utilize a method other than the 'turnover-based' method, prior written approval from SARS must be obtained.

**The Standard turnover-based method**

As highlighted above, the VAT Act itself does not provide details of the method of apportionment to be used by a vendor. The Act does however, permit SARS to prescribe the method by issuing a binding general ruling (ie 'BGR') in terms of section 41B. In this regard, SARS has issued a binding general ruling effective from 1 April 2007 which prescribes the 'turnover-based' method[30].

[30] Refer to Chapter 7.4 of the VAT 404 Guide for Vendors and Binding General Ruling No.16 (Issue 2) dated 30 March 2015 issued by SARS.

Prior to 2000, vendors could opt between the two methods of apportionment (i.e. the input based method or turnover based method). Furthermore, if the vendor felt neither method was appropriate, they could apply to SARS for approval of an alternative method. Now, unless a vendor is in possession of a binding general ruling stating the contrary, the vendor is obliged to use the turnover based method.

Formula: Turnover–based method of apportionment [31]

Formula: $y = a \times 100$

$(a + b + c)$ 1

Where:

y = the apportionment ratio/percentage;

a = the value of all taxable supplies (including deemed taxable supplies) made during the period;

b = the value of all exempt supplies made during the period; and

c = the sum of any other amounts of income 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).

The VAT 404 Guide, further provides that the following amounts must be excluded from the calculation of the ratio –

- the value of supply of capital goods or services other than goods supplied under a rental agreement or operating lease; and
- the value of any goods or services supplied for which an input tax deduction is specifically denied.

It should be noted that the 'c' in the formula is not restricted to supplies made during the period but includes any amounts received or accrued. In this regard, items such as dividends would be included and could have a significant impact on the vendor's ratio. Furthermore, any vendor

[31] The formula in respect of the turnover-based method of apportionment constitutes a binding general ruling and is set out in BGR 16 issued in accordance with section 89 of the Tax Administration Act and is effective from 1 April 2015.

seeking to exclude dividends on the basis that limited infrastructure is employed to generate such income is required to apply to SARS for a binding general ruling towards that effect.

In terms of the calculation, a vendor may opt to base the ratio on amounts pertaining to the previous financial year instead of amounts for the month under review. In the event the vendor opts for the mentioned election, the vendor must ensure that the ratio applied is consistently applied till the end of the current financial year, at which time new ratios should be calculated. Any resulting adjustments should be made within three months after the financial year end.

**The varied input-based method**

The above mentioned 'turnover-based' method is an apportionment method under the output principle in contrast to the 'input-based' method, which is a method principle based towards inputs. The varied input based method varies from the original input based method which was used as a standard method prior to 2000, in that the VAT incurred on mixed supplies is now excluded from the denominator. In terms of the varied 'input-based' method, the portion representing the taxable use of the goods and services is calculated by using the ratio of VAT incurred on goods or services acquired wholly for purposes of making taxable supplies, to the total VAT incurred on the acquisition of all goods and services during the tax period[32]. In other words, the method apportions the input tax claimable which cannot be related directly to either a taxable or non-taxable supply (Silver & Beneke 2015).

The SARS VAT 404 Guide, further provides that the following amounts must be excluded from the calculation of the ratio –

- the value of supply of capital goods or services other than goods supplied under a rental agreement; and
- the value of any goods or services supplied for which an input tax deduction is specifically denied.

[32] The VAT incurred for the purposes of making both taxable and exempt supplies is excluded (i.e. mixed supplies).

Example: Varied input–based method of apportionment

Silver & Beneke (2015) provide a brief example below:

Assume that a vendor during a tax period acquires goods for R114 000 (including VAT), for the purposes of generating both taxable and exempt supplies. The taxable use of such goods is not estimated to exceed 95% of their total usage. The following is a breakdown of the total VAT incurred during the tax period:

- wholly for the purposes of making taxable supplies R40 000
- wholly for the purposes of making non-taxable (including exempt) supplies R20 000
- partially for making taxable supplies R14 000
- Acquisition of capital goods or services wholly attributable to making taxable supplies R50 000
- Acquisition of goods or services for which an input tax deduction is denied R30 000

Total VAT incurred R154 00

The proportion of the R14 000 VAT, which is deductible is calculated as follows:

$$\frac{\text{VAT wholly attributable to making taxable supplies (less exclusions)}}{\text{Total VAT incurred (excluding VAT on mixed supplies and exclusions)}} \times \frac{100}{1}$$

$$\frac{(40\,000 + 50\,000 + 30\,000) - (50\,000 + 30\,000)}{154\,000 - (14\,000 + 50\,000 + 30\,000)} \times \frac{100}{1}$$

= 66.67% attributable to the making of taxable supplies and is deductible (ie 66.67% x R14 000 = R9334)

According to the SARS VAT 404 Guide the varied 'input-based' method can no longer be applied without prior written approval from SARS.

**Apportionment methodology applied by education institutions**

As previously highlighted, there is no definition of education found in the VAT Act. As a result, it becomes challenging in determining the ambit in terms of what is educational in nature and what is not, and where the line should be drawn between the two. The distinction is of high importance as educational services are exempt from VAT, whereas other activities might not be for example certain research activities which may be standard rated.

Botes & De Wet (2006) provides a listing of the primary income that an educational institution receives, but is not limited to as follows[33]:

- grants and subsidies based on the amount of students at the university received from national government;
- tuition income from the students (including boarding income);
- donations;
- funding for research of an educational nature;
- contract income/research done for commercial organisations;
- interest and dividend income from investments;
- gains on investments; and
- other income, for example rental income, investment from associates, etc.

As illustrated above, the definition for 'association not for gain' provides for the characterization of an educational institute. The definition suggests the service rendered should not be with the sole purpose of making a gain for its proprietor, member or shareholder. Furthermore the definition further mentions that any property or income should be utilized for the purposes in furthering its objective. No individual is permitted to generate a profit from the institution except if the payment is made to a specific person and is a payment made in good faith which encompasses a reasonable remuneration for services rendered. In other words the institutions primary goal should be to promote education. It should be noted that the VAT Act refers to educational service and not educational institutions. Therefore, services rendered by an educational institution, for example the leasing of facilities for a function, could be seen as a taxable supply and excluded from the exemption. As educational institutions generate both taxable and exempt supplies, the input tax that can be attributed to both activities should be apportioned.

[33] This list provided is not exhaustive and would be institution dependent.

**The treatment of the supply of accommodation to university students and non-students.**

Higher learning institutions also offer students with accessibility to on campus accommodation in the form of hostels. Students often pay separate fees for these accommodation facilities apart from tuition charges. Furthermore, some hostel accommodation offer the supply meals and others do not. (Lomofsky & Lazarus 2001)

Generally, a university term is between 80 and 90 days during which students are permitted to stay in the hostels. During holidays most students evacuate the hostels but some students elect to stay. The hostel accommodation is also sometimes rented out to third parties (non-students) during the holiday period. The fees paid by the students for hostel accommodation cover certain domestic goods and services such as electricity and water, a bed and a study desk, maintenance as well as other furniture and fittings etcetera. (Lomofsky & Lazarus 2001)

It has been argued that the supply of accommodation by these institutions to third party non-students would constitute a supply of 'commercial accommodation' for VAT purposes (Botes & De Wet 2006). Often in practice, as the consideration charged would be aligned to the market related rate, it will be more likely that not that the total receipts from such activities would exceed R 60 000 in a given 12-month period. In this regard, these institutions should charge 14% VAT on 60% of the all-inclusive charge (i.e. a charge for the accommodation including cleaning and maintenance, electricity, fittings but excluding meals) to the student where the student is provided with accommodation for an unbroken period of 28 days or longer (Botes & De Wet 2006). There has been an ongoing debate between SARS and the education institutions as to whether the supply of accommodation should be treated in the form of commercial accommodation (Carelse 2015). The opposing view is that the accommodation supplied is mainly used by students and the renting out to third party individuals over the holiday period is ancillary. SARS' view on the matter is outlined in the *SARS VAT 411 – Guide for Entertainment, Accommodation and Catering* (SARS, 2016c) ('SARS VAT 411 Guide'), which makes specific reference to lodging or board and lodging supplied by educational institutions in this regard.

Section 12(*h*)(ii) provides an exemption for the 'lodging or board and lodging' supplied by educational institutions. Section 12(*h*)(ii) states the following:

> ii) the supply by a school, university, technikon or college solely or mainly for the benefit of its learners or students of goods or services (including domestic goods and services) necessary for and subordinate and incidental to the supply of services referred to in subparagraph (i) of this paragraph, if such goods or services are supplied for a consideration in the form of school fees, tuition fees or payment for board and lodging;

The SARS VAT 411 Guide provides that in relation to the above, the following conditions are required to be met in order for the exemption to apply:

- The supplier must be an educational institution[34] mentioned in section 12(*h*)(i) which supplies exempt educational services, e.g. a school, university, technikon or college.
- The goods and services[35] supplied must be solely or mainly for the benefit of the educational institution's learners or students.
- The supplies must be necessary for, and subordinate and incidental to, the supply of the educational services.

In order to qualify for the exemption the additional goods and services must be supplied for any consideration in the form of the payment of school fees or tuition fees, or payment for board and lodging. If the fees charged fall outside this category, they are subject to tax if the educational institution is a vendor. The word 'mainly' is interpreted to mean greater than 50% (Silver & Beneke 2015).

The SARS VAT 411 Guide provides further, that the wording of the exemption refers to 'lodging or board and lodging', and not to a 'dwelling' (as defined). In this regard, the provision therefore exempts what may potentially have otherwise been regarded as commercial accommodation.

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

[35] Constituting accommodation, meals and various other supplies in the nature of 'domestic good and services' supplied together with the accommodation.

Further, the VAT 414 Guide alliterates that the supplies will not be taxable as long as the type of supplies usually made with the accommodation units and related facilities are solely or mainly for the benefit of the educational institutions own learners or students. Whilst the lodging or board and lodging may be necessary and incidental to the educational services, it is not a requirement that the goods and services must be supplied by the same educational institution. For example, the accommodation might be provided at one institution, but lectures may take place at another venue. In so far as the educational institution which provides the education, levies the tuition fees takes into account the costs of the entire exempt educational package of goods and services provided to the student or learner in return for those fees. The SARS VAT 414 further states:

> It also does not matter if the charges for board and lodging or other items such as study material are itemised separately from the bare tuition fee. The exemption will apply as long as those goods and services are necessary for, subordinate and incidental to the educational services.

In circumstances where an educational institution supplies accommodation or meals to educators for no consideration, or for a consideration which does not encompass all the direct and indirect costs of making the supplies, the value of supply is deemed to be nil and the educational institution will not be entitled to claim any input tax in this regard. Alternatively, where the meals and accommodation are of the nature supplied mainly for the benefit of students, any consideration paid in relation thereto will be exempt. (Botes & De Wet 2006)

The SARS VAT 411 Guide maintains that a distinction must be made between goods and services supplied by the educational institution as an integral part of the education, and any other supplies which are made separately and which may be taxable. The following scenarios are presented:

- Supplies made by the educational institution itself which are not necessary for, subordinate and incidental to the educational services, or which are not solely or mainly for the benefit of students[36].

[36] Examples of this nature include supplies made via vending machines, the rental of sporting facilities and halls for private functions, advertising services rendered in return for sponsorships and entrance fees charged to attend sporting events.

- The supply of fixed property under a lease agreement to independent vendors operating on the premises of the educational institution (e.g. a university bookshop or a restaurant).

In the *National Educare Forum v CSARS 2002,* it was held that the payment made by the Provincial Government to the taxpayer, a non-profit organisation in order for the organisation to effect delivery of food items to school children constituted consideration for a supply other than the payment of school fees or tuition fees for board and lodging and was accordingly not an exempt supply.

The VAT position in respect to such activities was discussed in official rulings issued in August of 1992. The following was presented (Silver & Beneke 2015):

- Where a conference or workshop was presented under the auspices of the educational institution, any amount charged for the conference or workshop was exempt from VAT. In addition any charge for accommodation provided to the participants was also exempt[37].
- In the event the conference is not presented by the educational institution, any charge made in respect of the accommodation is a taxable supply. Where the educational institution provides accommodation to delegates of such conference at a price which does not cover the cost of such accommodation, the educational institution is not entitled to claim any input tax deduction in respect of any goods or services acquired as the accommodation charge will not constitute a taxable supply.
- Where accommodation is provided to students of the educational institution attending a sports meeting, any charge is exempt from VAT. The supply of accommodation to other parties is a taxable supply charged at the standard rate, provided that the charge covers the associated costs thereof. If it does not cover the cost there is no taxable supply and no input tax deduction may be claimed.

[37] These are usually supplies of goods or services which fall into the category of 'entertainment'. In terms of section 17(2)(*a*) of the Value-Added Tax Act No. 89 of 1991, a vendor is not entitled to deduct any amount of input tax in respect of goods or services acquired for the purposes of 'entertainment', unless certain exceptions apply.

- The provision of the educational institutions sporting facilities to sports bodies or organisers is considered a taxable supply.

The above rulings were however withdrawn in 2009 and are no longer applicable. Now, where educational institutions make taxable supplies of more than R1 million per annum, they are obliged to register for VAT purposes.

Conclusion

The requirement to register has become a tangible need for most institutions as they generate a mixture of supplies and are required to perform complex high level apportionment ratio calculations (Alderman & Del Ninno 1999). It is often challenging for these institutions whom do not possess the relevant expertise and often have to outsource such functions to third party service providers to perform in order to comply. Such factors form an additional costing that must be borne which is inadvertently passed on to the students to endure in the form of increased tuition fees (Alderman & Del Ninno 1999). In the absence of a definition for educational it becomes challenging in determining the ambit in terms of what is educational in nature and what is not. As South African higher educational institutions and providers of educational services in the private sector generate significant values of exempt supplies, the de minimus rule is generally not met. Consequently, these institutions are required to restrict their input tax deductions to an apportioned rate. Many higher education institutions and those institutions in the private education sector have opted to use the varied input apportionment method as opposed to the 'turnover-based' method (Bowman 2014). In this regard, with the ongoing debate towards the classification of the supply of accommodation by education institutions to third party individuals as a supply of commercial accommodation could see the supply being taxed as standard rated supply (Carelse 2015). At present the supply this nature is exempt as it is seen to be provided solely or mainly for the benefit of students (Silver & Beneke 2015). Should the consensus change in this regard, the nature of the supply will be seen as mixed (i.e. an exempt supply when provided to students and a taxable supply when provided to other third parties) and be removed from the denominator of the varied input based method formula. The overall effect would result in the apportionment ratio of the education institution to increase

exponentially and therefore allowing the institution to claim more input tax. In addition the burden of extensive costs the government endeavoured to remove has inadvertently shifted to the student to assume if the current legislation is followed (Lomofsky & Lazarus 2001).

## CHAPTER 10 – RECOMMENDATIONS AND PROPOSED CHANGES

The purpose of this chapter is to discuss the alternative measures and methods of treatment the State should consider bringing into the framework of the VAT system where educational services are concerned.

### The implementation of zero rating on all educational services

The first consideration is for the VAT treatment of educational services to be changed from being exempt to that of zero rating. The change will reduce the administrative burden placed on the providers of educational services in keeping with the original intention set forth in the VATCOM (Lomofsky & Lazarus 2001).

Exempting educational services is inefficient as it leads to the VAT being trapped, which in turn leads to the various complexities as discussed above. The intention for exempting education in 1991, as set out in the VATCOM was a desire to keep the VAT system simple, motivate the importance of education and retain no net gain to the fiscus in the form of issuing further taxes. Similarly reducing the administrative burden of schools having to register for VAT and submit VAT returns. The continued exempting of education is in conflict with the initial intention of the legislation.

Institutes in the present day can no longer simply function on government subsidies alone and have to be proactive in terms of generating additional funds (Radcliffe 2014). These taxable activities have included them in the VAT net and they are therefore required to register (Silver & Beneke 2015). This in turn has created the added obligation of having to perform and implement complicated apportionment calculations, which is an exercise many institutions are not equipped to execute (Silver & Beneke 2015).

Additional considerations

As highlighted previously, the zero rating of educational services can be restricted to those institutes only, who upon dissolution, are required to transfer their assets to another institute carrying on similar activities (ie, entities qualifying and registering as PBO's). Many of the public institutions would fall within the PBO category as their objectives are grounded in promoting education and not to trade for profit or gain. The supply of education by private institutions which are not registered PBO's and do not adhere to the above requirements, would be subject to VAT at the standard rate (Silver & Beneke 2015).

**Removal of the Exemption from Welfare organization activities**

The second consideration is the inclusion of educational services as a welfare activity, which will entitle these entities to claim deductions on additional expenditure and costs incurred, which would accordingly relieve the burden of trapped VAT.

The principle in terms of granting a benefit to certain organizations yielding taxable supplies already exists by means of the welfare organization vehicle for VAT purposes. This in turn permits organizations to register for VAT purposes notwithstanding that goods and services are supplied for no consideration.

As many educational institutions are registered PBO's, the expansion of the definition of welfare activities to include educational services is not a foreign concept and has been proven successful.

Additional considerations

Public or state schools and educational institutions, should have the option to register as they would benefit from generating additional supplies and activities (Alderman & Del Ninno 1999).

**Distinction made between different eligible bodies and services they render**

The third consideration is the adoption of the treatment applied in foreign jurisdictions, such as Australia, whose legislation is similar to the legislation objectives in SA, where distinction is made between the different class of educational institutes and the method of VAT treatment applied, be aligned thereto. Thus no singular treatment be applied to the entirety of the education fraternity, such as the standard exemption (zero rating), but special concession be made individually in terms of the degree and level of knowledge transferred (Gendron 2009). Thus a combination of the zero or standard rating be employed dependent on the classification and class the institute belongs to. This will provide various avenues of relief and decrease the burden of non-recoverable VAT.

A distinction between the diverse eligible bodies with respect of the educational services they offer (state vs private; primary vs tertiary) and the zero or standard rating based on this will provide relief. Thereby creating a mandate of the standard VAT rate to be applied to certain institutions and the granting of an exemption (zero rating) to the other (McMillan & Western 2000).

As different organizations, such as universities, offer a higher level of learning as opposed to primary education, they incur relatively higher costs of administration which can only be supplemented through additional funding (Silver & Beneke 2015). The denial of recovery of such costs places a burden on the student as they are the final consumer. This makes education inaccessible and expensive (De la Feria & Krever 2013).

Additional considerations

In order to maintain a form of equalization, institutions who do not meet the requirements laid out would then standard rate such supplies (Silver & Beneke 2015).

**Standard Rating of Educational Services**

The fourth consideration is taxing educational services at the standard rate. The implementing of standard rating of educational services as opposed to the exemption will assist in simplifying the compliance responsibility. The fourth consideration, although not the most favourable of options, will at most provide a practical and efficient pathway of recovery that will eliminate the shifting of any trapped VAT that may be embedded in higher fees and tuition costs (De la Feria & Krever 2013).

As mentioned in above, the cost burden for most institutions which have no other means of recovery is often compensated by the students themselves in the form of increased tuition fees or alternative means of funding. Standard rating all these services, creates certainty, unlocks the VAT and simplifies the VAT treatment (Schenk 2009).

Furthermore, the standard rating treatment is in line with the initial intention of the legislation i.e. to keep the compliance burden to a minimum. Often these institutions are not equipped to handle fairly complex VAT legislation dealing with apportionment. Not only is the administrative burden greater but such institutes are often required to outsource or incur substantial professional fees for assistance in this regard. This in essence is an expense which could rather be expended in funding education further.

Additional considerations

The exemption was imposed with the intention of reducing compliance costs by conferring a simpler basis of taxation. This, however is no longer achieved. The standard rating of educational services would present the least amount of administration burden to the State, in that it can be governed with less effort. The State would also need to consider the state of mind of the student affected as they would see the application of the standard rate as an increase in the tuition fee.

**Reduced Rate for Educational Services**

The fifth and last consideration is for the State to reduce the VAT rate in respect to educational services. As opposed to the standard VAT rate of 14%, a reduced lower rate should be implemented with specific reference to educational services. This in turn will encompass all the benefits as discussed under the standard rating consideration, but would be more favorable in that the rate would be implemented at a minimum. The State would also need to consider the state of mind of the student affected as they would see the application of the reduced rate as an increase in the tuition fee even if minimally affected or raised as a result.

## CHAPTER 11 – CONCLUSION

Many educational institutions are working hard to become more flexible and responsive. In each sector, the industrial-age model of one size fits all is being discarded to serve more diverse demands (Alderman & Del Ninno 1999). The result is greater differentiation between institutions in each sector. Almost all educational institutions are striving to reach a new balance between their social responsibilities, their role as vital cultural institutions and the imperatives of new technologies and new economies (Dela *et al* 2001). In other words they are continually reinventing themselves. It appears, what has always been called education is therefore changing, not just in South Africa but world-wide (Carelse 2015). Furthermore, like other key institutions of family, work and government, education similarly requires reinvention to cater for such demands.

The exemption of education may serve its purpose in theory, however the practical implication does not warrant the exemption of such in its own right. The South African VAT system displays characteristics of mostly a traditional VAT system, however a migration to a post-modern VAT system should be further considered where the supply of educational services is standard rated or zero rated within a certain threshold and is governed by a separate set of rules.

Educational services are an exempt supply under section 12(*h*) of the VAT Act. The main reason for the exemption of educational services is that many of the institutions providing educational services are government institutions and to some extent financed by the government. Over the years, however, the activities of institutions providing educational services have changed drastically and are no longer primarily financed through government subsidies. In order to aid government grants and increase income, these institutions have increased their taxable activates considerably. Furthermore privately owned institutions are accountable for their own costs and are not provided any subvention from the State.

Numerous educational institutions within South Africa do not only provide educational services, but also conduct an enterprise with the supply of taxable supplies, which are then taxed at the standard rate. This in turn has created complications in respect to the administration of the VAT Act, whereby these service providers are then required to carry out an apportionment of VAT to encumber the mixed supplies. This practice is inefficient and not cost effective. Furthermore the ease of compliance of which was the basis in implementing the exemption is diminished as registration for VAT purposes is unavoidable.

Institutions that manufacture taxable supplies would be incurring inputs on associated costs. The effect of exempting educational services from the VAT net ultimately results in an increase in tuition as the burden of 'hidden' or 'trapped' cost is passed onto the student, as a result of institutions inability to claim a refund of the tax paid (Lomofsky & Lazarus 2001). As there is no recovery of input tax embedded in the price of exempt supplies, the cost of the tax included in the price must be borne by the entity that acquires the exempt supply and can only be recovered if the tax is passed on to customers (Silver & Beneke 2015). This is in effect contradictory to the initial intention of the exemption as it was administered for the benefit of the student. The contrary is true in terms of the zero rated supplies since the supplier is allowed to deduct the input VAT and there is no residual VAT inclusive in the final price.

Where an entity is already registered for VAT, the levying of VAT (whether at the standard rate or zero-rate) on these services will not necessarily increase the administrative burden as the entity is already required to submit VAT returns etc. The administrative burden is facilitated through the implementation of the user friendly eFiling system provides and an ease and simplification in terms of the submission of returns.

Furthermore, special consideration should be given to higher education facilitators as their educational service offering is distinctive, multifaceted and more costly to accommodate and dispense. Private institutions whom absorb costs through their own funding should be given certain preference as they are not primarily financed by the State and should be entitled to recover costs.

Many sectors of the education sector can benefit for the generating of taxable supplies (from schools to colleges and universities) if they are provided with a path of recovery in terms of the associated costs incurred. With that being said, one should be bear in mind that the reform should be by way of a tax vehicle that does not increase the students' tuitions fees which in turn brands education as unaffordable to many.

The State needs to address current challenges faced in the industry and transform with the evolution of education in implement a tax reform that meets the needs of the students together with the institutions that serve. In so doing, further clarity is required in terms of the activities that constitute educational services and the activities that fall out of the ambit. As education institutions generate various streams of revenue for e.g., application fees and a range of levies. At present many institutions are treating the majority avenue of activities as exempt, with a few exceptions being treated as taxable. SARS should provide a clear listing in this regard and provide prior concession for non-compliance towards institutions that have yet to conform, as any changes made with respect to the VAT treatment on educational services could create potential VAT exposures where penalties and levies could be administered thereon.

To this extent a similar change in policy approach be taken in respect of section 12(*h*) that was transitioned in the Municipal Industry following the Minister's Budget speech in 2006 regarding the zero-rating of municipal rates and the VAT implications with respect to Municipalities.

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**ANNEXURES**

- **Annexure 1** – Relevant Extract of the VATCOM
- **Annexure 2** – The list of Registered Private FETs as updated on 09 January 2012
- **Annexure 3** – List of activities classified as welfare activities
- **Annexure 4** – The 2014 HESA Annual report
- **Annexure 5** – The Apportionment flow diagram