REPUBLIC OF SOUTH AFRICA

TAX COURT OF SOUTH AFRICA

WESTERN CAPE DIVISION, CAPE TOWN

CASE NO: VAT 1908

(1)	REPORTABLE: YES/NO
(2)	OF INTEREST TO OTHER JUDGES: YES/NO
(3)	REVISED.
.....	.....
DATE	SIGNATURE

In the matter between:

ABC TRADING Appellant

and

THE COMMISSIONER FOR
THE SOUTH AFRICAN REVENUE SERVICE Respondent

J U D G M E N T

Court: Justice J Cloete, Prof P Surtees (Accountant Member) *et* Ms Y Molefe (Commercial Member)

Heard: 3 June 2021

Delivered electronically: 21 June 2021

CLOETE J

Introduction

[1] The appellant conducts the business of administering funeral policies on behalf of a long-term insurer ("the insurer"). It is both a registered VAT vendor and financial services provider. Its business involves negotiating policies on behalf of the insurer; collecting these premiums and paying them over to the insurer; submitting detailed monthly collection reports; and processing claims by beneficiaries.

[2] For these services the appellant is paid an administration fee which is calculated in accordance with the written Administration Agreement ("agreement") concluded between the appellant and the insurer on 6 July 2015.[1]

[3] On 31 October 2016 the appellant applied to SARS to be deregistered as a VAT vendor. On 6 June 2017 SARS responded as follows:

> '3. From the information supplied it seems if the company is not providing insurance under a long-term insurance contract but only acts as an administrator for the insurance company. For these services the company is charging an administrative fee that is subject to VAT in terms of section 7(1)(*a*) of the VAT Act. The company's turnover also exceeds the minimum threshold for compulsory registration in terms of section 23(1) – and does not qualify to cancel their VAT registration in terms of section 24(1) of the VAT Act…
>
> 5. Your request for deregistration cannot be granted at this time…'

[4] Following an unsuccessful objection and appeal to the Tax Board, the appellant approached this court for relief. The core issue is whether or not the appellant is entitled to such deregistration. However, before turning to that issue, we deal with the preliminary issue raised.

Preliminary Issue: Mootness

[5] SARS issued a notice of cancellation of the appellant's VAT registration on 22 March 2019, after delivery of its rule 31 statement on 27 November 2018. At paragraph 11.3 of SARS' proposed pre-trial minute dated 19 June 2020 it is recorded that this was issued in error, and that such error would be rectified in terms of section 9 of the TAA[2]. It was further recorded that SARS would revert to the appellant in that regard. There was no indication in the Dossier whether this "error" had been rectified, and in paragraphs 11 to 13 of the appellant's

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1 Effective 1 March 2013 and which replaced the previous agreement concluded between the appellant and the insurer.

2 Tax Administration Act 28 of 2011.

differentiating pre-trial minute these recordals were placed squarely in dispute. SARS also indicated that it would not be calling any witnesses.

[6] In heads of argument the appellant, relying on the decisions in *Purlish*[3] and *Brummeria*,[4] submitted that SARS was precluded from disputing the deregistration in this court. Both *Purlish* and *Brummeria* dealt with the situation where one of the parties sought to raise issues not covered in their respective rule 31 or 32 statements for adjudication before the court. Counsel were thus requested to prepare to address the court on this issue at the hearing.

[7] *Mr L*, who appeared for the appellant, placed on record that about a week after delivery of the appellant's differentiating pre-trial minute (on 2 July 2020) the appellant indeed received from SARS a notice of withdrawal of its cancellation of deregistration. It is common cause that neither party made discovery of this notice during the pre-trial process. *Mr D*, who appeared on behalf of SARS, indicated that he had a draft copy of a letter pertaining to that notice in his possession (the original was presumably in the possession of the appellant). Counsel were *ad idem* that the draft in *Mr D's* possession was to all intents and purposes the same as that received by the appellant. *Mr L* also accepted that the notice was competently issued by SARS in terms of section 9 of the TAA, and that the administrative decision to which it pertained stands until set aside by a court,[5] but submitted that, given the absence of the notice in the Dossier, the court might conclude that it could not be placed before us.

[8] *Mr D* on the other hand submitted that the notice, if handed in, should be considered as being properly before the court, given the appellant's concession that it had indeed been received and the absence of any consequent prejudice to the appellant. In addition he submitted that the court should have regard to all relevant evidence in order to arrive at a fully informed decision.

[9] After conferring we agreed that the notice should be admitted into the record and ruled accordingly, with reasons to follow as part of our judgment. These reasons are briefly as follows. First, the notice itself is relevant only to the issue of mootness. It has no bearing on the core issue for which both parties had fully prepared. Second, the rule 31 statement was delivered on 28 November 2018 and the rule 32 statement on 8 August 2019. The rule 32 statement addressed the earlier notice of deregistration of 22 March 2019, although it did not, since it could not, address the later notice of withdrawal of cancellation which was only

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3 *Purlish v C.SARS* 81 SATC.204.

4 *C.SARS v Brummeria Renaissance (Pty) Ltd* 69 SATC 205.

5 *Oudekraal Estates (Pty) Ltd v City of Cape Town and Others* 2004 (6) SA 222 (SCA); *MEC for Health, Eastern Cape and Another v Kirland Investments (Pty) Ltd t/a Eye & Lazer Institute* 2014 (3) SA 481 (CC).

despatched to the appellant on about 9 July 2020, long after the 20-day period for SARS to deliver its reply in terms of rule 33(1)(*b*) of the tax court rules.

[10] The parties were at liberty to amend their respective statements by agreement to bring this development to the attention of the court in terms of tax court rule 35(1) or, in the event of there being no agreement, to apply to the tax court for such an amendment in terms of tax court rule 52. Both failed to do so although both were aware of this development since at least July 2020.

[11] There could be no question of prejudice to either had this been done. That this did not occur (for whatever reason), to exclude it solely on that basis would have been to place form over substance, and would have resulted in us approaching determination of the matter on an artificial basis. The notice of withdrawal of cancellation was therefore accepted into the record as Exhibit "A" and argument proceeded on the core issue.

Core Issue

[12] This involves a consideration of the terms of the agreement concluded between the appellant and the insurer, viewed against the relevant provisions of the VAT Act.[6] It is common cause that the sole business of the insurer is the provision of funeral policies.

[13] Counsel were also *ad idem* that the administration services rendered by the appellant in terms of the agreement constitute an "intermediary service" as defined in section 1 of the FAIS Act[7] but that, for purposes of determining the core issue, no regard should be had to that Act but only to the deeming provisions of what constitute a "financial service" in section 2 of the VAT Act, and more particularly section 2(1)(*i*) and the proviso to section 2:

> '2. **Financial services**.—(1) For the purposes of this Act, the following activities shall be deemed to be financial services:
>
> (i) The provision, or transfer of ownership, of a long-term insurance policy…
>
> Provided that the activities contemplated in paragraphs (*a*), (*b*), (*c*), (*d*) and (*f*) shall not be deemed to be financial services to the extent that the consideration payable in respect thereof is any fee, commission, merchant's discount or similar charge, excluding any discounting cost.'

[14] The agreement stipulates *inter alia* that the appellant may not determine the premiums under any policy administered by it.[8] This instead falls within the sole discretion of the insurer, the business of which, it is common cause, constitutes a financial service for purposes of section 2(1)(*i*) of the VAT Act.

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6 Value-Added Tax Act 89 of 1991.
7 Financial Advisory and Intermediary Services Act 37 of 2002.
8 Annexure "A", Dossier p168.

[15] The evidence of Mr P (who testified for the appellant in his capacity as its compliance officer) was that the fees which the appellant is paid by the insurer for performing its administration services form part of the premium and are determined on a sliding scale, depending upon the number of policy holders in any given group client. The premiums themselves have no built-in VAT component.

[16] The insurer is VAT exempt in terms of section 12 of the VAT Act as a supplier of a deemed financial service as defined in section 2(1)(i) of that Act. It was common cause during argument that the appellant does not charge the insurer VAT on its fees, although there is nothing in the agreement to preclude it from doing so and, in any event, given its VAT registration the appellant has an obligation to charge VAT.

[17] It was also accepted on behalf of the appellant that it incurs expenditure in the operation of its administration business (the fees it is paid by the insurer in terms of the agreement are its sole source of income) and that at least some of this expenditure results in it incurring input tax.

[18] There is no dispute that if the appellant were to charge the insurer output tax it would be able to claim the difference between its input and output tax from SARS. This falls outside the premium itself, since the premium does not accrue to the appellant but only to the insurer. Put differently, the appellant merely administers the premium and is paid a fee for this service (P's evidence confirmed this).

[19] Section 2(1) of the VAT Act previously deemed the following activities to be financial services:

> '(*m*) the payment or collection on someone else's behalf of any amount of interest, principal, dividend or other amount whatever in respect of any debt security, equity security, participatory security, a credit agreement, any life insurance policy, superannuation scheme or futures contract;
>
> (n) agreeing to do, or arranging, any of the activities specified in paragraphs (*a*) to (*m*)
>
> Provided that the service of providing advice directly in connection with any of the activities specified in paragraphs (*a*) to (*m*), for which a separate fee is charged, shall not be deemed to be a financial service.'

[20] Section 2(1)(*m*) was repealed on 25 November 1994.[9] Section 2(1)(*n*) was amended on 25 November 1994 and subsequently repealed on 3 July 1996.[10] The administration services performed by the appellant on behalf of the insurer would have fallen within section 2(1)(*m*) and (*n*), and would thus have fallen within the definition of "financial services" for purposes of the VAT Act.

[21] The appellant's argument is that notwithstanding the repeal of the aforementioned sub-sections, its business nonetheless qualifies as a deemed financial service since the proviso to section 2(1) of the VAT Act does not refer to section 2(1)(*i*). Accordingly, it is submitted, by necessary implication the legislature intended that the fees earned by it (and other enterprises conducting similar services) fall outside the exclusions in that proviso, and are therefore exempt in terms of section 12 of the VAT Act.

[22] There is a fundament flaw in this argument. As submitted by counsel for SARS the determining factor is rather whether or not the appellant's business constitutes the 'provision of a long-term insurance policy' in terms of section 2(1)(*i*). If not, the proviso becomes irrelevant.

[23] While the appellant may be advancing the services of the insurer, it does so as an independent contractor. Clause 5.3 of the agreement provides as follows:

> 'The Administrator acts for all purposes hereunder as an independent contractor and a financial services provider in terms of law. Neither the Administrator nor any of its representatives or employees shall act or hold themselves out as representatives or employees of the insurer for any purpose whatsoever.'

[24] The parties agree that the VAT consequences of the agreement must be determined in light of the terms of the agreement itself. As was stated in *ITC 1933:*[11]

> 'I am inclined to agree with previous authorities cited herein above that when assessing the VAT consequences of a supply, that must be assessed by reference, first and foremost, to the contractual arrangement under which the supply is made. What is crucial is the ascertainment of the legal rights and duties which are contractually created by the transaction into which the parties entered…'

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9 Taxation Laws Amendment Act 20 of 1994, date of commencement 25 November 1994.
10 Taxation Laws Amendment Act 37 of 1996, with date of commencement 3 July 1996.
11 82 SATC 388 at para [44].

[25] Annexure “A” to the agreement sets out the services which the appellant is obliged to render to the insurer. They could perhaps more appropriately have been referred to in the agreement as “the rights and obligations” of the appellant. Be that as it may, the annexure makes clear the following.

[26] First, the entering into, varying or renewal of a policy must be approved by the insurer before it comes into force. Second, as previously stated, the appellant has no authority to determine the premiums under a policy. The same applies to determining the wording of a policy or the value of policy benefits. These lie solely in the discretion of the insurer.

[27] Third, the appellant is not authorised to settle a claim under a policy. It may pay claims but has no authority to reject them. Any variation in benefit needs to be referred to the insurer for prior approval. While the appellant is authorised to collect the claims documentation and vet same to form an opinion about whether the claim should be settled or rejected, the insurer has the final say. Once it has made its decision, that is communicated to the appellant who ‘shall then pay the claim and communicate this payment or rejection to the Policyholder or claimant’.

[28] The appellant is obliged to make disclosures on behalf of the insurer to policy holders and to create and maintain records for the insurer. Although Mr. P in his testimony explained that in practice the parties do not always adhere strictly to the procedures in Annexure “A” because of the urgency in processing these claims in certain instances, this practice cannot affect or influence the terms of the agreement itself.

[29] The agreement makes clear that the services performed by the appellant are purely administrative ones for which the appellant is paid a fee. It does not provide a long-term insurance policy. The insurer does that. Accordingly, the activities of the appellant cannot be deemed to be “financial services” for purposes of section 2(1) of the VAT Act.

[30] The appellant also placed reliance on SARS Binding General Ruling (VAT): No 34 issued on 14 April 2016.[12] Its purpose and scope is to grant long-term insurers permission to use a particular method in determining the consideration for the supply of management services to a superannuation scheme where the consideration for such supply is not separately reflected but is embedded in the premium payable in terms of a long-term insurance policy. This is because the long-term insurer is therefore required to determine the cost of making that supply. It is recorded in paragraph 2 of the ruling that:

> ‘…A difficulty however exists relating to the identification of specific expenses incurred for the management of superannuation schemes, other than direct costs, as this activity is not distinct

[12] Dossier pp49 to 52.

> from the activities conducted in the course or furtherance of providing long-term insurance policies.
>
> All costs incurred in the course or furtherance of the administration activities fall within the scope of the provision of a long-term insurance policy, that is, an exempt supply, whereas the costs incurred in the course or furtherance of the management activities fall within the scope of managing a superannuation scheme, that is, a taxable supply…'

[31] We agree with the submission by counsel for SARS that what this ruling is intended to cover are long-term insurers who manage the administration of their schemes internally, as opposed to outsourcing them, as is the case in the present matter. Given that the appellant is an independent contractor Annexure "C" to the agreement sets out the remuneration payable to it for its services:

> 'In consideration for the Services rendered by the Administrator to the Insurer, the Administrator shall be entitled to negotiate with its client a percentage of the gross premiums received by the Administrator plus VAT (if applicable) as remuneration. This remuneration shall be approved by the Insurer and recorded on the policy document for the Policy or scheme.'

[32] Accordingly, in terms of the agreement itself, the appellant is entitled to negotiate its own fee plus VAT (if applicable). This is then intended to be recorded in the particular policy document. The difficulty identified by SARS in its Binding General Ruling does not, therefore, arise.

[33] As further support for its argument that the services which it provides to the insurer are VAT exempt, the appellant also referred to the explanation given by Silke,[13] as follows:

> 'The administration and management fees in respect of a long-term insurance policy are also exempt as it is not one of the fee-based financial services contemplated in the proviso of section 2, and therefore not excluded as an exempt supply.'

[34] In our view however, this takes the matter no further, given the conclusion reached above that the appellant's business does not fall within the deeming provision of a "financial service" for purposes of section 2(1)(i) of the VAT Act.

Costs

[35] Both parties persisted in claiming costs. Section 130(1) of the TAA makes clear that a tax court has a discretion to award costs in favour of a party if the other's grounds advanced are held to be unreasonable and/or the tax board's decision is substantially confirmed. While the effect of our decision is to substantially confirm that of the tax board, we are nonetheless of the view that no order should be made as to costs. Neither party has conducted themselves

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[13] Silke: Income Tax, vol 2, 2017, p1053 at para 32.11.1.

unreasonably, and the issues before us are hardly clear-cut. It is thus appropriate that each party should pay their own costs.

[36] The following order is made:

1. The taxpayer's appeal is dismissed.
2. No order is made as to costs.

J I CLOETE