THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Reportable

Case no: 330/2019

In the matter between:

DIAGEO SOUTH AFRICA (PTY) LTD **APPELLANT**

and

COMMISSIONER FOR THE SOUTH AFRICA REVENUE SERVICE **RESPONDENT**

Neutral citation: Diageo South Africa (Pty) Ltd *v Commissioner for the South African Revenue Service* (330/2019) [2020] ZASCA 34 (03 April 2020)

Coram: PETSE DP, SWAIN, MBHA, MAKGOKA and MBATHA JJA

Heard: 27 February 2020

Delivered: 03 April 2020

Summary: Value Added Tax Act 89 of 1991 – interpretation of s 8(15) – deeming provision – single supply of advertising and promotional goods and services to non-resident entities – applicability of deeming provision applied to goods portion of the supply – VAT at standard rate correctly levied in terms of s 7(1)*(a)* of the Act.

ORDER

On appeal from: The Tax Court, Cape Town (Savage J), sitting as court of first instance):

The appeal is dismissed with costs, such costs to include the costs of two counsel.

JUDGMENT

Mbha JA (Petse DP, Swain, Makgoka and Mbatha JJA concurring)

[1] This appeal concerns the proper interpretation and application of s 8(15) of the Value Added Tax Act 89 of 1991 (the Act), in the context of a single supply of advertising and promotional goods and services (the A&P services) by the appellant, Diageo South Africa (Pty) Ltd (Diageo), a South African VAT vendor, to various non-resident entities (the brand owners).

[2] Diageo made supplies of the A&P services to the brand owners and levied a fee for the supplies during its VAT periods ending June 2009, 2010 and 2011. Pursuant to s 11(2)*(l)* of the Act, Diageo charged VAT on the said fee at zero percent. However, the respondent, the Commissioner for the South African Revenue Service (the Commissioner), invoked s (8)(15) of the Act and maintained that Diageo had made deemed separate supplies of zero rated A&P services and standard rated goods in the form of promotional giveaways and samples that were not exported but consumed in the Republic of South Africa (the Republic).

[3] Section 8(15) provides as follows:

'For the purposes of this Act, where a single supply of goods or services or of goods and services would, if separate considerations had been payable, have been charged with tax in part at the rate

applicable under section 7(1)*(a)* and in part at the rate applicable under section 11, each part of the supply concerned shall be deemed to be separate supply.'

[4] Section 7(1)*(a)* of the Act levies VAT at a standard rate on the supply by a vendor of goods and services supplied in the course or furtherance of an enterprise. The zero rating provisions in terms of s 11, constitute an exception to this general rule. These include services supplied to non-residents of the Republic in terms of s 11(2)*(l)* of the Act.[1]

[5] The Commissioner assessed Diageo for additional output VAT on the goods component of the supply of the A&P services rendered by Diageo to the brand owners during the aforementioned periods. Diageo's output VAT was accordingly adjusted by the inclusion of the further amounts of R3 444 764 (June 2009), R4 631 620 (June 2010) and R5 932 209 (June 2011).

[6] Diageo challenged the additional assessment in the Tax Court, Cape Town (Savage J), contending that it made a supply only of zero-rated A&P services to the brand owners and that it did not make separate or dissociable supplies of both services and goods. The Tax Court disagreed and held that the supply of promotional goods, as a portion of the single A&P service was, by virtue of s 8(15), a cognisable supply of goods capable of notional separation from the total A&P services supplied to the brand owners. This local supply of promotional goods, not exported but consumed in the Republic, was accordingly deemed to be a separate supply, and

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[1] Section 11(2)*(l)* provides in relevant part as follows:
'(2) Where, but for this section, a supply of service would be charged with tax at the rate referred to in section 7(1), such supply of services shall be charged with tax . . . at the rate of zero-percent where –
(*l*) the services are supplied for and to a person who is not a resident of the Republic or a specified country and who is outside the Republic and the specified countries at the time the services are rendered, not being services which are supplied directly in connection with –
(i) . . .
(ii) . . .'

VAT at the standard rate in terms of s 7(1)*(a)* of the Act, was justifiably levied on these goods, with the result that the additional assessments were confirmed. Diageo was therefore liable for the VAT output tax adjustment under s 8(15) in respect of the A&P services costs incurred by Diageo constituting goods not exported but consumed in the Republic. This appeal, with the leave of the Tax Court, is against that finding.

[7] The factual matrix against which the dispute in this appeal falls to be determined, can be summarised as follows:

(i) Diageo, which is engaged in the business of the importation, manufacturing and distribution of alcoholic beverages, entered into an agreement with foreign brand owners for the advertising and promotion of their alcoholic products in South Africa. The brand owners granted Diageo the exclusive rights in respect of the brands distributed by Diageo to use the brand owners' trademarks, intellectual property, equipment, packages and labels in South Africa;

(ii) The brand owners invested in advertising and promotions to build and maintain brand recognition and perception, with the aim of generating sales and sustainable long term cash flow, by way of enhanced brand equity. The brand owners however did not perform or undertake these activities themselves in respect of their brands. They relied instead on Diageo which rendered these services to the brand owners in return for a fee, which was calculated with reference to the costs and expenditure incurred on advertising and promoting the brand owners' brands;

(iii) The advertising and marketing activities consisted of a range of activities such as advertising from various channels, brand building promotions, events, sponsorships and market research. Services which were rendered by Diageo included advertising media cost and digital, website design and build, social networks and sponsorship of, amongst others, sports events. In addition, Diageo

made use of promotional merchandise and packaging; alcoholic products for sampling; and branded giveaways items such as glasses, optics, towels, beer mats, lanyards, keyrings, T-shirts, aprons, caps and the like. These were given away free of charge to third parties for use or consumption within the Republic for purposes of promoting the product;

(iv) The handing out of the physical goods by Diageo in the course of rendering the A&P services to the brand owners was not an end in itself but simply another means to enhance brand equity and sales. Two categories of goods were used. Firstly, products of the brand owners namely, alcoholic beverages were taken out of the trading stock and used for product sampling or tasting. Secondly, point of sales items such as branded glasses and T-shirts were given to third parties, for no consideration. Similarly, aprons and caps were supplied to employees at no cost to them;

(v) Importantly, it was left to the discretion of Diageo how much of the budget was to be spent on, for example, promotional giveaways and samples, which particular items were to be used and in what quantities and manner they were to be used and distributed. This activity was undertaken as part of an integrated and synergetic marketing campaign as the ultimate objective was to build and maintain the brand image;

(vi) The fee charged by Diageo to the brand owners represented the cost incurred by Diageo in rendering the A&P services, which comprised the supply of both goods and services, to the brand owners. However, the tax invoices rendered by Diageo to the brand owners reflected a total fee for services rendered. It did not differentiate between goods and services. Although such fee was charged through a South African joint-venture entity, known as Brandhouse Beverages, to which Diageo had outsourced the marketing function, the supply remained one by Diageo to the brand

owners. The fee was charged on the basis that it constituted a zero-rated supply of the A&P services in terms of s 11(2)*(l)* of the Act; and

(vii) The brand owners and Diageo split the A&P services expenditure 50:50 up to 15 percent of net sales value. The brand owners funded the balance of the A&P services expenditure in instances where it exceeded 15 percent. The portion of the A&P services expenditure funded by Diageo was accordingly limited to a maximum of 7.5 percent of the net sales values for each brand.

[8] Diageo submitted that s 8(15) is incapable of being applied to the facts of this case. Relying on certain foreign authorities,[2] Diageo contended that in order for s 8(15) to apply, it is required that a vendor must make 'separate dissociable supplies of both services and goods' or supplies that are 'economically divisible, independent and hence dissociable' and which constitute 'an end in itself', not a means to achieve that end. In Diageo's view, the A&P services concerned in this case were not such a supply as they did not involve an independent supply of goods capable of standing alone for VAT purposes, as something separate from the A&P services. The section did not deem supplies to be separate when they were economically not dissociable.

[9] In support of its contention that the A&P services it provided to the brand owners were not economically dissociable, Diageo submitted that the sole contractual obligation owed by it to the brand owners was to provide a service for the purposes of the Act, and that it owed no contractual obligation to the brand

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[2] *Card Protection Plan Ltd v Commissioners of Customs and Excise (European Court of Justice)* case number c-349/96; *Auckland Institute of Studies Ltd v Commissioner of Inland Revenue* (2002) 20 NZTC 17, 685 (HC); *Revenue and Customs Commissioners v Weight Watches (UK) Ltd* [2008] STC 2313. The principles underpinning the European and New Zealand approach is the emphasis on distilling on the basis of the totality of the evidence, the essential features of the transaction, and thereby (i) determining the economic or commercial reality of the transaction, (ii) examining the supply from the point of view of the consumer, and (iii) avoiding the 'unreal' situation that would result from an overzealous and artificial dissection of the transaction into components that are economically not dissociable.

owners to supply goods at all. In other words, its use and distribution of promotional goods was not an end in itself, but a means to achieve the objective of the preservation and enhancement of the brands, through the provision of the A&P services. The fact that it incurred expenditure in acquiring goods for the purpose of enabling it to supply a service, did not mean that it supplied both goods and services.

[10] According to Diageo, there was only a 'single supply' for purposes of s 8(15) where what was presented as a single supply was in fact a conglomeration of economically divisible, independent and hence dissociable supplies. Section 8(15) then deemed these independent supplies to be separate supplies, each carrying its own VAT treatment. The purpose of the section was thus not the creation of an economically, or commercially unreal outcome, but rather the avoidance of one. Therefore, the section did not deem single supplies to be separate when they were dissociable. On this basis, Diageo claimed that the Commissioner's approach erroneously sought to artificially dissect a single supply and that the Commissioner's interpretation of the section produced artificial and insensible results.

[11] The Commissioner, on the other hand, submitted that s 8(15) is a deeming provision which postulates a state of affairs that does not exist, but is to be taken to exist. In this regard, the Commissioner reasoned as follows:

(i) The invoice issued by Diageo to the brand owners was in respect of the rendering of a single supply;

(ii) Notwithstanding this, the supply rendered to the brand owners comprised both goods and services;

(iii) For purposes of s 8(15), if separate considerations had been payable by the brand owners (in respect of the single supply of services by Diageo), and would have resulted in tax charged in part in terms of the standard rate and in part in terms of the zero rate, each part of the supply (goods and services) shall be deemed to be a separate supply;

(iv) Therefore, to the extent that the supplies made by Diageo constituted a supply of goods, and such goods were not exported but consumed in the Republic, such supply was subject to VAT at the standard rate in terms of s 7(1)*(a)* of the Act. Such supply of goods was accordingly deemed to be a separate supply for purposes of the s 8(15) deeming provision.

[12] Section 8(15) is, as the Commissioner has correctly submitted, a deeming provision. Section 8, under which it is located, is headed 'Certain supplies of goods or services deemed to be made or not made'. The effect thereof was aptly summed up as follows in *Mouton v Boland Bank*:[3]

'The intention of a deeming provision, in laying down an hypothesis, is that the hypothesis shall be carried as far as necessary to achieve the legislative purpose, but no further.'

[13] The jurisdictional requirements that must be met before the deeming provision can be invoked are, first, a 'single supply' of two or more types of goods or services or a combination of goods and services. Secondly, one consideration must be payable as only a single supply is made. Lastly, the circumstances must be such that if the supply of the goods or services or of the goods and services had been charged for separately, part of the supply would have been standard rated and part zero-rated ('notional separate considerations').

[14] In addition, s 8(15) must be interpreted in the context of the provisions of s 7(1)*(a)* of the Act, in terms of which the supply of goods and services by a vendor, in the course or furtherance of an enterprise, attracts VAT at a standard rate, and s 11(2)*(l)* which constitutes an exception to the provisions of s 7. As previously explained, goods or services, or goods and services supplied to non-residents in the

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[3] *Mouton v Boland Bank* 2001 (3) SA 877 (SCA) para 13, quoting from Bennion Statutory Interpretation 3rd ed sec 304 at 736.

Republic are zero-rated in terms of s 11(2)*(l)*. Simply put, the purpose of s 8(15) is to provide, by way of a deeming provision, for a situation where the provisions of ss 7(1)*(a)* and 11(2)*(l)* of the Act are implicated in a single supply of goods, or services, or goods and services so that the appropriate rate of VAT is charged in respect of the particular goods or services or goods and services supplied.

[15] In an attempt to bolster its argument that s 8(15) did not apply in this case, Diageo sought to rely on the terms of its agreement with the brand owners that it was contracted to supply only a single A&P service, and that it consequently invoiced the brand owners for that single supply of an A&P service, and not for goods which were only an incidental element of the supply of the A&P services. The Commissioner pointed out, correctly in my view, that the single supply provided by Diageo to the brand owners consisted of both goods and services that were distinct and clearly identifiable from each other. Only one consideration was payable to Diageo in respect of that single supply. Had separate considerations been payable in respect of the goods and of the services, part of the supply (the goods consumed in the Republic) would have been standard-rated and the part consisting of the services supplied to non-residents would have been zero-rated. Thus, by application of s 8(15), each part of the supply was deemed to be a separate supply. The supply of goods forming part of the A&P services rendered by Diageo to the brand owners therefore constituted a standard rated supply.

[16] Diageo's reliance on foreign authorities is in my view, unhelpful. As the Commissioner correctly submitted, these do not deal with the interpretation of statutory provisions that are the functional equivalent of the deeming provision or an apportionment provision as one finds in s 8(15) of the Act. Thus, formulations such as 'economically not dissociable', 'the supply not being an end in itself' and the question of 'principal and ancillary supplies', which find expression in those

authorities, play no role whatsoever in the interpretation and application of s 8(15). Furthermore, the respective statutory provisions have very little in common with s 8(15) of the Act.

[17] For s 8(15) to apply, it only has to be determined whether 'each part of a single supply' properly falls within its ambit for the deeming provisions to be triggered. The meaning of the section was clearly described in *Commissioner, South African Revenue Service v British Airways plc* 2005 (4) (SCA) 231 in the following terms (paras 10 and 11):

'The section applies to a single supply of goods or services comprising parts that would each, if they had been supplied separately, have attracted a different rate of tax. In such cases, each part of the single service is deemed to be a separate supply of goods or services – although, in truth, they are not – with the result that the separate parts each attract the tax that is levied by s 7 but at different rates (0% for that part of the service that, had it been separately supplied, would have fallen within s 11, and 14% for the remainder).

A "single supply of services" is only capable of notional separation into its component parts, as contemplated by the section, if the same vendor supplies more than one service, each of which, had it been supplied separately, would have attracted a different tax rate. If that were not so, there would be no parts of the "single supply of services" by the vendor capable of notional separation from one another.'

Of significance to the present appeal is what was stated at para 13:

'. . . The section does no more than apportion the rate at which the vendor is required to pay the tax that is levied by s 7 when the vendor has supplied different goods or services as a composite whole.'

[18] Having regard to the facts of this case, I find that the provision of the A&P services by the appellant, Diageo, to the foreign based brand owners comprised a single supply of goods and services, which, if they had been supplied separately, would have attracted a different rate of tax and for which a single consideration was payable. The jurisdictional requirements of s 8(15) were therefore satisfied with the

result that the deeming provision had the effect of notionally separating the supply of services from the supply of goods, when in fact they were not separate supplies. Furthermore, there can be no justification for importing into s 8(15) a requirement derived from foreign authorities, as the appellant would have it, that the deeming provision may apply only to a single supply of economically divisible, independent and hence dissociable supplies of goods and services.

[19] Accordingly, Diageo's criticism of the approach of the Commissioner and the Tax Court to the interpretation of s 8(15), that it produced an artificial and insensible result and a commercially unreal outcome, cannot be justified. To the contrary, that approach accords with this Court's dictum in *Natal Joint Municipal Pension Fund v Endumeni*,[4] that:

'. . . Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the *context* in which the provision appears; the apparent *purpose to* which it is directed and the material known to those responsible for its production. Where more than one meaning is possible each possibility must be weighed in the light of all these factors. The process is objective not subjective. *A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results* or undermines the apparent purpose of the document.' (Emphasis added.)

[20] As I have shown above the meaning of s 8(15) of the Act is clear. Its purpose is to ensure that in a case like the present the appellant and other similarly positioned VAT vendors fulfil their obligation to pay VAT at the standard rate on the goods that they have supplied. Clearly, this cannot be an artificial and insensible result and does not in any way produce a commercially unreal outcome.

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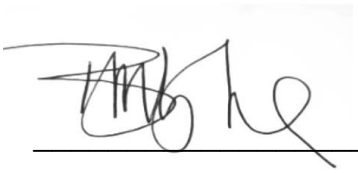
[4] *Natal Joint Municipal Pension Fund v Endumeni* [2012] ZASCA 13; 2012 (4) SA 593 (SCA) para 18.

[21] In the light of all what I have stated above, I find that the appellant is accordingly liable for the VAT output tax adjustments under s 8(15) of the Act in respect of advertising and promotional costs incurred by the appellant constituting goods, not exported but consumed in the Republic.

[22] I accordingly make the following order:

The appeal is dismissed with costs, such costs to include the costs of two counsel.



B H MBHA

JUDGE OF APPEAL

Appearances

For appellant:	M Janisch SC (with him M Blumberg)
Instructed by:	Webber Wentzel, Cape Town;
	Honey Attorneys Inc, Bloemfontein
For respondent:	A R Sholto-Douglas SC (with him H Cassim)
Instructed by:	State Attorney, Cape Town;
	State Attorney, Bloemfontein.