IN THE TAX COURT

[HELD AT CAPE TOWN]

Case No: VAT 1558

In the matter between:

ABC (PTY) LTD Appellant

and

THE COMMISSIONER FOR

THE SOUTH AFRICAN REVENUE SERVICE Respondent

Date of hearing : 22 – 24 October 2018

Date of judgment : 5 December 2018

JUDGMENT

SAVAGE J:

Introduction

[1] This matter is concerned with the interpretation and application of s 8(15) of the Value-Added Tax Act 89 of 1991 ('the Act'). It takes the form of an appeal against additional Value-Added Tax ('VAT') assessments raised by the respondent, the Commissioner for the South African Revenue Service ('CSARS'), against the appellant, ABC (Pty) Ltd, in the amount of R3 444 764 for its 06/2009, R4 631 620 for its 06/2010 and R5 932 209 for its 06/2011, VAT periods and interest.

[2] The facts are not in dispute. The appellant, a South African VAT vendor, manufactures and distributes drinking beverages in South Africa under a variety of brands – not as owner of the brands, but in terms of an exclusive rights distribution agreement entered into with foreign offshore entities (the 'brand owners'). In doing so the appellant uses

the brand owners' trademarks and intellectual property. The brand owners invest in the advertising and promotion ('A&P') of the brands 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.

[3] The appellant provides a single supply of an A&P service to the foreign brand owners, using its subsidiary and joint venture partner, X Entity, having outsourced its sales, marketing and distribution operations to X Entity. For the A&P service provided, the appellant invoices the foreign brand owners a fee. This is calculated with reference to the annual amount spent (through the payment of a fee to X Entity) on A&P expenditure, without differentiating on the tax invoice between services rendered to the brand owners and goods consumed within South Africa. The brand owners and the appellant split the funding of A&P expenditure on a 50:50 basis up to 15% of net sales value for the brand in question, above which the brand owner funds the balance. The appellant's costs include advertising and promotional costs, including expenditure incurred in relation to goods which take the form of promotional products distributed locally such as gifts, competitions, display materials, personality promotions, promotional items such as lanyards and t-shirts, product tastings and local product giveaways.

[4] The CSARS raised additional VAT assessments against the appellant for its 2009, 2010 and 2011 vat periods in terms of which VAT was levied at the rate of 14% in terms of s 7(1)(*a*) of the Act on the goods part of the supply of the A&P service provided by the appellant to the brand owners. The remainder of the A&P service supplied was accepted by CSARS as having been properly zero-rated by the appellant in terms of s 11(2)(*l*). The basis for the additional VAT assessments raised was that the supply of promotional products was deemed a separate supply of goods in terms of s 8(15).

[5] Section 8(15) of the Act provides, in relevant part:

> '(15) 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 a separate supply.'

[6] Having been deemed in terms of s 8(15) to be a separate supply of goods, such supply was assessed not to qualify for zero-rating in terms of s 11(2)(*l*) but to constitute a standard-rated supply in terms of s 7(1)(*a*).

[7] Section 7(1)(*a*) provides that:

> '(1) Subject to the exemptions, exceptions, deductions and adjustments provided for in this Act, there shall be levied and paid for the benefit of the National Revenue Fund a tax, to be known as value added tax—
>
> (*a*) on the supply by any vendor of goods or services supplied by him on or after the commencement date in the course or furtherance of any enterprise carried out by him; …'

[8] Section 11(2)(*l*) states:

> '(2) Where, but for this section, a supply of services…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 to a person who is not a resident of the Republic, not being services which are supplied directly—
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> …
>
> (ii) in connection with movable property…situated inside the Republic at the time the services are rendered…'

Appellant's case

[9] The appellant seeks that the disputed assessments and interest be set aside on the basis that s 8(15) can only apply to different, independently cognisable services supplied together, when such supplies could sensibly have been supplied separately for their own sake. The provision, it is submitted, does not permit an artificial dissection of a single non-dissociable service supplied into separate components or supplies, each carrying its own VAT treatment.

[10] The evidence of Mr V, who was employed by the appellant in a senior role responsible for marketing, was that the appellant's contractual obligation was to provide a single A&P service to the brand owners, who set the strategic direction and identity of the brand, drove brand performance at global level, established global marketing strategies and controlled production and innovation activities. The appellant was granted considerable latitude to tailor the distribution and marketing of products to bring this in line with the strategy set by the brand owners given its local market knowledge. It therefore determined the particular A&P activities undertaken in any year and the amounts expended on each activity, as part of an integrated marketing campaign to build and maintain the brand owners' brand image and enhance the brand owners' brand equity.

[11] Mr V stated that the marketing plan comprised of an integrated mix of media, promotions, sponsorships, relationship marketing, product giveaways and sampling, with two categories of physical goods used locally: products taken out of stock for use in product sampling or tasting; and point of sale items such as branded glassware, t-shirts, and lanyards to raise brand awareness and advertise the product. He stated that the use and distribution of promotional goods was not undertaken as an end in itself or as a distinct supply, but as a means to achieve the objective of the preservation and enhancement of the brands. From a commercial perspective, according to Mr V, it did not make sense to separate out the goods component from other components of the service provided. He disputed that promotional goods were given away by the appellant for no return, since the return was an enhancement of brand equity for the brand owners.

[12] Mr W, a chartered accountant employed in a financial controller role in the appellant's tax and treasury department, undertook what he stated was an 'artificial' exercise to extricate the cost of the various promotional items and product released from stock to marketing in the supply of the A&P service to brand owners. His evidence was that this exercise demonstrated that the value of such items typically was below 20% of the total A&P spend in a given year.

[13] Counsel for the appellant argued that its contractual obligation to foreign brand owners was to provide an A&P service to build and maintain brand recognition and growth for brand owners. In providing this service, X Entity distributed the tasting stock and promotional materials directly to members of the public not as an aim in itself but to preserve and enhance brand equity for foreign brand owners. The distribution of these goods was merely a facet of the A&P service supplied and not a distinct supply. In this regard, it was functionally no different from the distribution of other promotional or advertising material such as flyers or pamphlets. The supply in its entirety should therefore be zero-rated in terms of s 11(2)(*l*) of the Act in that it constituted the provision of services and to separate the supply of goods from the provision of the A&P service would distort the functioning of the VAT system. This would require an impractical or unbusinesslike interpretation of s 8(15), one which is commercially unrealistic, artificial and narrow.[1]

[14] An interpretation and application of s 8(15) should not, it was argued, lead to an absurd result that the supply of the same goods would carry two independent VAT consequences: as a supply for no consideration; and as a taxable supply for consideration. Rather, an analysis of the economic nature of the transaction is required so as to determine

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[1] With reference to *Natal Joint Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) at para 26.

its commercial reality.[2] With reference to *Commissioner, South African Revenue Service v British Airways plc*[3] in which the "*separate service*" was found not to have been supplied by the taxpayer, despite British Airways having paid for that service from the Airports Company and having recovered the cost from the customer, it was argued that the only cognisable supply of goods in this matter was made by X Entity directly to the customer (i.e. the member of the public) and not by the appellant to the brand owners.

[15] The appellant relied on foreign jurisprudence in support of the contention that it was artificial to separate the single A&P service supplied to the brand owners when it is economically dissociable into component parts; and that s 8(15) does not impel otherwise. It was argued that, consonant with the principles of our law, in matters such as *Revenue and Customs Commissioners v Weight Watchers (UK) Ltd,*[4] *Card Protection Plan Ltd v Commissioners of Customs and Excise*,[5] *Card Protection Plan Ltd v Customs and Excise Commissioners*,[6] *College of Estate Management v Customs and Excise Commissioners,*[7] *EC Commission v United Kingdom* [8] and *Auckland Institute of Studies Ltd v CIR,*[9] it was required that the essential features of the transaction be determined on a consideration of the totality of the evidence. This allows (i) a determination of the economic or commercial reality of the transaction; (ii) an examination of the supply from the point of view of the consumer; and (iii) it avoids the commercially "*unreal*" situation that would result from an overzealous and artificial dissection of the transaction into components when the elements of the transaction are '*economically dissociable*' from each other.[10]

[16] It was argued further that the appellant's contractual obligation is to provide a service to brand owners, with no enforceable obligation to supply any goods to the brand owners, and it would be artificial and incorrect to find that a '*supply of goods*' had been made by the appellant to the brand owners when X Entity gives items away to third parties to whom the brand owners have no contractual or other obligation. Even if there was such a supply, it was not an aim in itself but merely a means to deliver a part of what the A&P service for which brand owners had contracted the appellant. For VAT purposes, the appellant

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2 With reference to *Commissioner for the South African Revenue Service v NWK Ltd* 2011 (2) SA 67 (SCA); and *Roshcon (Pty) Ltd v Anchor Auto Body Builders CC and Others* 2014 (4) SA 319 (SCA).

3 *Commissioner, South African Revenue Service v British Airways plc* 2005 (4) SA 231 (SCA) at para 11.

4 [2008] STC 2313; [2008] EWCA Civ 715 (25 June 2008).

5 [1998] EUECJ C-349/96.

6 [2001] 2 All ER 149 (HL); [2001] UKHL 4.

7 [2005] All ER 933 (HL).

8 [1988] 2 All ER 557 (ECJ) at para 33.

9 (2002) 20 NZTC 17,685 (HC) at para 53.

10 *Card Protection Plan Ltd v Customs and Excise Commissioners* [2001] 2 All ER 149 (HL); [2001] UKHL 4 at para 28 with reference to *Commission of the European Communities v United Kingdom and Northern Ireland* [1998] ECR 817.

contended that this constituted a supply from X Entity to the end-consumer for no consideration and at nil value under s 10(23). If X Entity charged the recipient a fee for the tasting, for example, that fee would attract VAT payable by the recipient.

[17] If it was found that the appellant did make the giveaways of promotional items '*to*' the brand owners, such a supply cannot be elevated to an independent supply so as to allow separate VAT treatment under s 8(15) given that the distribution of promotional items by the appellant is not an aim in itself. This is so in that it would lead to absurd or commercially unrealistic consequences when the distribution of promotional goods is no different from the distribution of promotional material such as flyers or pamphlets, which are a means to enhance and promote the brand.

[18] Since s 8(15) can only apply to different, independently cognisable services supplied together, which could sensibly have been supplied separately for their own sake and own consideration, and not to a single, non-dissociable service. A common sense approach to the matter is required to determine what the brand owners are contracting to receive from the appellant in exchange for its fee. This, it was argued, is distinguishable from where a single consideration is given for different things in a composite supply when the multiple supplies are economically dissociable, such as the purchase of goods from a supermarket, in which case each component supply should be accorded its own independent VAT treatment, irrespective of the fact that a single consideration is paid.

[19] On the basis that the supply made to brand owners constituted a supply of services and not goods it was contended that the zero-rated provisions of s 11(2)(*l*) applied in that the A&P service was supplied to the brand owners who were not residents of the Republic and that none of the exceptions to s 11(2)(*l*) apply. Although reliance was initially placed on the CSARS general written ruling 187 (GWR 187),[11] the appellant accepted that the ruling was withdrawn effective from 1 November 2009 and that such ruling is not applicable in this matter.

Submissions for the CSARS

[20] No witnesses testified for the CSARS. It was submitted by respondent's counsel that the proper interpretation of s 8(15) allows for separately cognisable supplies of services and goods, supplied as a single supply, to receive separate VAT treatment where the jurisdictional requirements are present. In this matter a single supply has been rendered by the appellant to foreign brand owners of both goods and services; only one consideration is payable; and, if the supply of the goods or services or of the goods and services had been

[11] GWR 187 issued on 21 April 1992 and amended on 1 September 2002 concerned with '*Marketing services for overseas companies*'.

charged for separately, part of the supply would have been standard-rated and part zero-rated. Once an apportionment is capable of being made, it was submitted, this is the end of the enquiry.

[21] Although the appellant invoiced the brand owners for the supply of an A&P service and not for goods, the single supply provided by the appellant to the brand owners consisted of both goods and services which were clearly identifiable and, with the expenditure incurred for both goods and services. From the agreement between the appellant and the foreign brand owners and the evidence of Mr Stephen it was possible to separate the amount sought from the brand owners in respect of promotional products. The deeming provision on this basis became operative. It was submitted to be artificial for the appellant to accept that it incurred A&P expenditure for goods and services which it could recover from the brand owners, but then contend that such recovery did not include the expenditure in relation to goods but only services when factually the recovery of A&P expenditure related to both the supply of goods and services.

[22] With reference to *Commissioner, South African Revenue Service v De Beers Consolidated Mines Ltd,*[12] the caution was sounded regarding placing reliance on foreign case law. This, on the basis that foreign concepts such as whether a single supply is '*economically dissociable*' do not apply since they arise in the context of there being no apportionment provision in European VAT law. The result is that those courts have had to develop a jurisprudence to determine when and in what circumstances it is appropriate to regard a composite service as separate supplies. The enquiry in this matter turns on the requirements of s 8(15), which contains a deeming provision. The provision postulates a state of affairs that does not in fact exist but is to be taken to exist. If separate considerations had been payable by the foreign brand owners in respect of the single supply made by the appellant, this would have resulted in VAT charged in part at the standard rate and in part at the zero rate, with each part of the supply of goods and services deemed to be a separate supply. In such circumstances, the supply of goods was deemed to be a separate supply for purposes of s 8(15), with the goods not exported but consumed in South Africa making the supply subject to VAT at the standard rate in terms of s 7(1)(*a*) of the Act. On this basis, the appellant is liable for the VAT output tax adjustment under s 8(15) in respect of A&P costs

[12] 2012 (5) SA 344 (SCA) at para 54 where it was stated: 'The parties' reliance on foreign precedent in this regard is misplaced. DBCM relied on *BJ Services Company Canada v The Queen* 2003 (TCC) 900; and SARS relied on *FCT v The Swan Brewery Co Ltd* (1991) 22 ATR 295 (FCA), which reached conflicting conclusions on substantially the same issue but in relation to provisions of the Canadian and Australian income tax statutes. The tests to be applied in terms of the relevant statutes differ from those of the Act, the facts differed from the facts of the present case and the cases did not deal with VAT or its equivalent in the two countries. The answer in the present case must be obtained by applying the provisions of the Act to the facts.'

incurred by it and the appeal consequently falls to be dismissed, with the additional assessments confirmed.

Evaluation

[23] Section 8(15) applies where there is a single supply of goods or services, or of goods and services by one vendor. It contains a deeming provision in terms of which the composite parts of a single supply are deemed to be separate supplies where, if the goods or services or goods and services had been supplied separately, each separate supply would have attracted a different VAT rate, one zero-rated and the other standard rated at 14%. In the current matter a single A&P service was supplied by the appellant to brand owners for which it was paid a fee ('*one consideration*'). This fee allowed the appellant to recover costs incurred in the provision of the A&P service, both in respect of goods and services from the brand owners. In issue is whether, in terms of s 8(15) '*if separate considerations had been payable*' different VAT rates would have applied and if so whether '*each part of the supply concerned shall be deemed to be a separate supply*'.

[24] A '*supply'* is defined in s 1 as –

> 'performance in terms of a sale, rental agreement, instalment credit agreement and all other forms of supply, whether voluntary, compulsory or by operation of law, irrespective of where the supply is effected, ...'.

[25] Section 1 defines '*services*' as –

> 'anything done or to be done, including the granting, assignment, cession or surrender of any right or the making available of any facility or advantage ...'.

[26] In s 1 '*goods'* are defined to mean –

> 'corporeal movable things, fixed property, any real right in any such thing or fixed property, and electricity ...'

[27] In *Commissioner, South African Revenue Service v British Airways plc*,[13] in which s 8(15) was found not to apply in that two vendors had supplied distinct services, it was stated that:

> '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 was not so there would be no parts of the "single supply of services" by the vendor capable of notional separation from one another.'

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[13] *Commissioner, South African Revenue Service v British Airways plc* 2005 (4) SA 231 (SCA) at para 11.

[28] In considering whether a notional separation of parts of the single supply made by the appellant is possible, regard must be had to the nature of the commercial transaction which makes up the single supply to determine if the payment of separate considerations would have been possible. Where it is not possible to separate the single supply into component parts to consider if separate considerations notionally could been payable and if so what tax implications would arise, s 8(15) will not apply.

[29] In *Card Protection Plan Ltd v Commissioners of Customs and Excise*, [14] the European Court of Justice cautioned that a single supply should not be artificially split and that the essential features of the transaction must be ascertained to determine whether several distinct principal services or a single service was being supplied, or whether a supply is ancillary to a principal supply if it does not constitute an aim in itself. The House of Lords in *Card Protection Plan Ltd v Customs and Excise Commissioners*[15] found that the essential features of the transaction should be considered to (i) determine the economic or commercial reality of the transaction, (ii) examine the supply from the point of view of the consumer, and (iii) avoid a commercially '*unreal*' situation that would result from an overzealous and artificial dissection of the transaction into components that are economically not dissociable.[16]

[30] In *College of Estate Management v Customs and Excise Commissioners*, [17] the House of Lords stated that it would be artificial and incorrect to regard the supply of printed materials as ancillary to the supply of educational services when the materials were the means by which the students obtained most of their education.[18] The fact that the supply of printed materials could not be regarded as ancillary did not mean it should be regarded as a separate supply for tax purposes;[19] and that even where –

> '…several services are performed in a transaction, none of which can be singled out as the dominant or principal supply, it may nevertheless be necessary to consider whether, for tax purposes, they are properly to be regarded as elements of a single supply.'[20]

[31] The Court in *EC Commission v United Kingdom*[21] found that the provision of the medical service with the supply of medicines and other goods, such as prescribed corrective spectacles, '*is physically and economically dissociable from the provision of a service*'.

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14 [1998] EUECJ C-349/96.
15 [2001] 2 All ER 149 (HL).
16 At para 28.
17 [2005] All ER 933 (HL).
18 See para 11 per Rodger LJ and para 31 per Walker LJ.
19 Para 12 per Rodger LJ.
20 Para 10. See also para 30 Walker LJ.
21 [1988] 2 All ER 557 (ECJ) at para 33.

The New Zealand High Court in *Auckland Institute of Studies Ltd v CIR*[22] considered s 5(4) of the New Zealand Goods and Services Act of 1985 which states:

> 'For the purposes of this Act, where a supply is charged with tax in part under section 8 of this Act and in part under section 11 of this Act, each part shall be deemed to be a separate supply'.

[32] It that matter the Court found, in relation to the provision of overseas educational services, that all overseas services constituted an integral part of the supply of tuition services and that it was not reasonable to sever and apportion the different parts of the services.

[33] It is so that the foreign authorities relied upon are concerned with the application and interpretation of statutory provisions distinct from s 8(15), with it only in *Auckland Institute of Studies Ltd v CIR*[23] that the applicable statute contained a deeming provision, which is in any event distinct from that existing in s 8(15). In this regard the caution sounded in *Commissioner, South Africa Revenue Service v De Beers Consolidated Mines Ltd,*[24] as to the usefulness of foreign authorities is relevant.

[34] Section 8(15) is concerned with a notional separation of supplies '*if separate considerations had been payable*' and not with, what was the fundamental question in the European jurisprudence, whether a transaction consists for VAT purposes of a single composite supply or multiple supplies in the absence of a deeming provision. Determining for purposes of s 8(15), if separate considerations are notionally payable does require the economic nature and commercial reality of the transaction to be considered. However, there is no requirement that any notional separation avoid what may be considered to be an artificial dissection of a transaction. What is required is the identification of a cognisable supply of goods or services sufficient to determine what the tax treatment of the notionally separated supplies would have been if separate considerations had been payable.

[35] Promotional products, as a cognisable supply of goods, were distributed locally by X Entity to local customers. This supply was made as part of the A&P strategy identified by Mr V in his evidence, with X Entity making this supply on behalf of the appellant in the performance of the appellant's contractual obligation to the brand owners. While neither the appellant nor X Entity were contractually obliged to supply promotional goods to consumers, they did so in accordance with the A&P strategy identified in the provision of the A&P service to foreign brand owners. The purpose of the supply of promotional goods was to increase brand equity and sales for the brand owners. This fell squarely within the ambit of the

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22 (2002) 20 NZTC 17,685 (HC) at para 53.
23 Supra.
24 2012 (5) SA 344 SCA at para 54.

provision of the single A&P service by the appellant to brand owners. The goods supplied locally were not an unrelated supply by X Entity to local customers for no consideration at nil value. As much was apparent from the evidence of Mr W who undertook a calculation of the cost of promotional products supplied and the percentage of such costs as part of the total fee charged to the brand owners. From his evidence it was therefore apparent that it was possible to consider '*if separate considerations had been payable*' whether the supply of promotional goods would have attracted different VAT consequences and could be deemed to be a separate supply for purposes of s 8(15).

[36] The A&P service supplied was not of such a nature that it made the notional separation of such supply into separate supplies of services and promotional goods impossible. The total A&P service supplied is not the only cognisable supply made to brand owners. The fact that the supply of promotional goods locally may have been a facet of the total A&P service provided does not mean that it is not capable of notional separation for purposes of s 8(15), nor is it so that the supply of goods will, if deemed a separate supply, result in their double VAT treatment.

[37] A deeming provision lays down a hypothesis to be '*carried as far as necessary to achieve the legislative purpose, but no further*'.[25] It must always be construed contextually and in relation to the legislative purpose.[26] Such a provision may deem something to be when it is in fact not so by indicating '*a state of affairs which does not in fact exist but is to be taken to exist*'.[27] The supply of promotional goods, as a portion of the single A&P service is, by virtue of s 8(15), a cognisable supply capable of notional separation from the total A&P service supplied to brand owners. Since it is deemed a separate supply with the goods liable to be subjected to different tax treatment, such supply does not receive double VAT treatment.

[38] The local supply of goods constitutes a supply of goods, not exported but consumed in South Africa, such supply is subject to VAT at the standard rate in terms of s 7(1)(*a*) of the VAT Act. Section 11(2)(*l*) does not apply given that it is concerned with the zero-rating of the supply of services. It follows that the appellant is accordingly liable for the VAT output tax adjustment under s 8(15) in respect of advertising and promotional costs incurred by the appellant constituting goods, not exported but consumed in the South Africa.

[39] It matters not that the foreign brand owners did not receive or consume the promotional goods and that the local customer did. The supply was made as part of the A&P service, to achieve the benefit of enhanced brand equity and sales for the foreign brand

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25 *Mouton v Boland Bank Ltd* 2001 (3) SA 877 (SCA) at para 13.

26 *S v Rosenthal* 1980 (1) SA 65 (A) 75G-H; *Eastern Cape Parks and Tourism Agency v Medbury (Pty) Ltd t/a Crown River Safari* 2018 (4) SA 206 (SCA) at paras 29 to 34.

27 *In re Dalton, Nuttall & Voysey Ltd* 1932 NPD 762 at 763.

owners, with the cost of such goods included in the fee charged by the appellant and paid by foreign brand owners. The A&P service supplied continued to enjoy substantial benefits of zero-rating in terms of s 11(2)(*l*), with it only the supply of those promotional goods capable of notional separation in terms of s 8(15) deemed a standard-rated supply. The fact that other promotional products were either not capable of or not considered for a notional separation from the single supply in terms of s 8(15) does not alter the result.

[40] For these reasons, the appeal must fail and the additional VAT assessments raised by the CSARS against the appellant stand to be confirmed. Costs were not sought and no order of costs is made.

[41] In the result, I make the following order:

Order

1. The appeal is dismissed and the additional assessments for the VAT periods 2009, 2010 and 2011 raised against the taxpayer by the Commissioner are confirmed.

K M SAVAGE

Judge of the High Court