South African Revenue Service

**INTERPRETATION NOTE 39 (Issue 3)**

DATE: 29 March 2017

**ACT : VALUE-ADDED TAX ACT 89 of 1991**
**SECTION : SECTIONS 1(1), 8, 11, 16, 18 AND 23**
**SUBJECT : VAT TREATMENT OF PUBLIC AUTHORITIES AND GRANTS**

**CONTENTS**

***Preamble***

In this Note unless the context indicates otherwise –

- **"2005 amendments"** means the relevant amendments to the VAT Act discussed in this Note which were made in terms of the Revenue Laws Amendment Act 45 of 2003 and the Revenue Laws Amendment Act 32 of 2004;
- **"DOR Act"** means the annual Division of Revenue Act;
- **"MFMA"** means the Municipal Finance Management Act 56 of 2003;
- **"PFMA"** means the Public Finance Management Act 1 of 1999;
- **"PSA"** means the Public Service Act, Proclamation 103 of 1994;
- **"section"** means a section of the VAT Act;
- **"VAT"** means value-added tax; and
- **"VAT Act"** means the Value-Added Tax Act 89 of 1991; and
- any other word or expression bears the meaning ascribed to it in the VAT Act.

All guides, interpretation notes and returns referred to are available on the SARS website at **www.sars.gov.za**. Unless indicated otherwise, the latest issues of these documents should be consulted.

## 1. Purpose

This Note deals with the VAT treatment of public authorities and grants. In particular, it explains the policy framework within which the law operates and the impact of the amendments in this regard which came into effect on 1 April 2005, especially the following:

(a) The application of the zero rate under sections 11(2)(*n*), 11(2)(*t*), 11(2)(*u*) and 11(1)(*r*) which deal with certain payments made by or to public authorities, constitutional institutions and municipalities.

(b) The application of the deeming provisions under sections 8(5) and 8(5A) in respect of certain supplies and payments made by or to public authorities, designated entities and municipalities.

(c) Distinguishing between a receipt or payment constituting consideration for an actual supply of goods or services which is taxable at the standard rate and the receipt or payment of an unrequited amount being a "grant".

(d) Determining whether or not an entity is a "public authority", and consequently, whether that entity must register and account for VAT.

(e) Determining whether certain input tax and output tax adjustments apply to public authorities.

In general, this Note aims to explain the VAT status of public authorities (government departments listed in the PSA and other quasi-government entities listed in the PFMA) and the VAT implications of different transactions that may be concluded between such entities and vendors, including the payment of grants.

Although there is some discussion regarding the VAT treatment of municipalities and municipal entities, the focus of this Note is on transactions between national and provincial departments forming the first two tiers of government and public entities listed in the PFMA and between such entities and different types of vendors.[1]

This Note does not deal with the interpretation of the law in respect of any payments to developers (including municipalities) by the Department of Human Settlements under a national housing programme as such amounts do not qualify as grants.

## 2. Introduction

### 2.1 Background to this Note

The Note was first drafted as a result of the need to explain a major shift in tax policy and a number of amendments to the VAT Act with effect from 1 April 2005 (the 2005 amendments) which put those policies into practice. Previous issues of this Note explained the interpretation of the law as it read both before and after 1 April 2005 to highlight the full range of issues concerning the application of the law and to explain the practical implications of the 2005 amendments.

As many of the compliance issues relating to the pre-April 2005 period have prescribed, in the current version of this Note, the detailed explanations regarding the pre-April 2005 have been reduced substantially. However, certain explanations relating to that period have been retained especially in so far as they help to explain the tax policy framework and important contextual issues behind the current wording of the VAT Act. Readers will therefore be referred to issue 2 of this Note which is available on the SARS website under the Legal Counsel archive where more detail regarding the pre-April 2005 period is required.

Extensive amendments to the VAT Act were also made on 1 July 2006 with regard to the VAT treatment of municipalities,[2] but these are only discussed to a limited extent, and within the context of the issues addressed in this Note.

### 2.2 Background to the issues before April 2005

Before 1 April 2005, when a vendor received a so-called “transfer payment” from a “public authority”, the deemed supply which arose was subject to VAT at the zero rate under section 11(2)(*p*) provided the payment was received for the purpose of making taxable supplies. The zero-rating under section 11(2)(*p*) was introduced as a temporary measure in 1991 when VAT was introduced to allow government departments sufficient time to effect the necessary adjustments to their budgets to take VAT into account. The provision was therefore never intended to be a permanent feature of the VAT Act.

With the rapid transformation of government structures from 1994, many of the functions previously performed by the national and provincial departments were transferred to public entities which had been specifically created to carry on those activities. This meant that the number of payments made between national and provincial departments, municipalities and public entities became more frequent.

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1 For a more comprehensive discussion on the VAT treatment of municipalities which form the third tier of government, see the *VAT 419 – Guide for Municipalities*.

2 The term “municipality” only substituted the term “local authority” on 1 July 2006 and not on 1 April 2005 which is the date that most of the 2005 amendments came into effect. See **4.5** for further discussion on this point.

These payments were also made for a variety of reasons which go beyond what was contemplated in the definition of "transfer payment". This resulted in many interpretation difficulties because of the different perceptions of the meaning of the term "transfer payment", as well as the uncertainty around the VAT status of the different types of public entities which were being created at the time.

The definition of "transfer payment" was amended a number of times to try and clarify the VAT treatment, but differences of opinion remained. In addition, difficulties were experienced with the VAT treatment of other payments such as equitable share grant payments made to municipalities under the DOR Act and payments made directly to third parties. Such payments did not fall within the definition of "transfer payment", but were generally perceived (incorrectly) to qualify for the zero-rating under section 11(2)(*p*).

When a public authority or municipality acquires goods from a vendor, it is normally quite clear that an actual taxable supply is made under section 7(1)(*a*) and there is no need to apply any deeming provision. However, when a third party becomes involved, the position becomes unclear. For example, when a public authority pays for a specific supply of goods or services made by a vendor to a third party, a question arises as to whether the supply is made to the person making payment, or the person receiving the supply. Also, the question arises as to whether there are two supplies (a deemed supply and an actual supply) to consider for VAT purposes, or only one. This, in turn, created further uncertainty as to the circumstances under which the zero-rating in section 11(2)(*p*) applied, as it was unlikely that such a payment could ever be regarded as a "transfer payment" as defined. Furthermore, with the intangible nature of services, it is often difficult to establish whether an actual supply of services has occurred or not.

The main concern in this regard was whether a zero-rated **deemed supply** arose in relation to a particular payment on the basis that it qualified as a "transfer payment", or if the receipt constituted payment for an **actual supply** of goods or services which was taxable at the standard rate. This uncertainty resulted in an inconsistent application of the law in respect of certain payments made by public authorities. An investigation was therefore undertaken by National Treasury and SARS to determine what the best practices were in regard to the VAT treatment of public bodies and the grants, subsidies or transfers of funds which they make to other vendors.

Following the investigation, a number of legislative amendments were made with effect from 1 April 2005 to clarify the VAT status of public authorities and public entities as well as the VAT treatment of payments which they make or receive.[3] These changes included, amongst others, the withdrawal of the zero-rating of transfer payments under section 11(2)(*p*); the introduction of new deeming provisions and definitions; the definition of "public authority" was amended to clarify which listed public entities qualify as public authorities; and the definition of "transfer payment" was deleted. The deleted provisions were replaced by the definition of "grant" and sections 11(2)(*s*) and 11(2)(*t*) (among others) were inserted to provide clarity on the VAT status of certain entities as well as which payments from government qualify to be subject to VAT at the zero rate.

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[3] The bulk of the amendments on this topic are contained in the Revenue Laws Amendment Act 45 of 2003 and the Revenue Laws Amendment Act 32 of 2004 ("the 2005 amendments"), but further minor amendments were included in subsequent amendment acts.

A summary of the general tax principles put into effect by the 2005 amendments and the effect that this had on different types of entities is set out briefly in **2.3** to **2.13**.[4]

## 2.3 General tax policy principles

The South African VAT system is based on the premise that government is the final consumer of goods and services[5] if it uses those inputs to provide goods or services on a non-commercial basis. In addition, the classification of public entities under the Schedules to the PFMA has, from 1 April 2005, been used as a basis for determining whether the entity concerned should be regarded as a "public authority" as defined in section 1(1), and consequently, whether that entity is regarded as carrying on an enterprise or not.

Since most of the supplies made by departments and certain government agencies are generally outside the scope of VAT, departments and government agencies will generally not be entitled to register for VAT. It follows that VAT is generally not charged by government and government agencies on any goods and services supplied to the public and any VAT incurred in acquiring goods or services to make those supplies is a cost to government.

Certain public entities that conduct enterprises, as well as welfare organisations and public private partnerships (PPPs) which make taxable supplies fall within the definition of "designated entity". If a designated entity receives any payment from a public authority, municipality or constitutional institution, it is **deemed to supply a taxable service** under section 8(5) to that entity provided that there is no **actual supply** under section 7(1)(*a*) to which that payment relates. The deemed supply is generally taxable at the standard rate, unless the payment is in respect of exempt supplies (for example, financial services). This is to ensure that entities in which government has an interest do not have an unfair competitive advantage over other vendors participating in the market for the same or similar goods or services.

As discussed later in this Note, a "grant" means any appropriation, grant in aid, subsidy or contribution transferred, granted or paid to a vendor by a public authority, municipality or constitutional institution. The deemed supply which arises as a result of the receipt of a grant is generally zero-rated in the hands of the recipient (not being a "designated entity"[6]). However, if the payment constitutes consideration for an actual supply of goods or services procured directly, or paid for on behalf of a third person by that public authority, municipality or constitutional institution, then the standard rate of VAT will apply.

The 2005 amendments resulted in many of the supplies made by government bodies and public entities no longer being subject to VAT, and meant that those entities were required to deregister for VAT. However, those entities were not required to pay output tax on the value of their assets on the date of deregistration under section 8(2). This was a special measure which was introduced.

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4 The tax policy framework as set out in these paragraphs has remained essentially unchanged since the 2005 amendments.

5 Under section 86, the State is bound by the provisions of the VAT Act.

6 There are two exceptions where the zero rate will apply, namely, when any training grant paid to a designated entity by a Sectoral Education Training Authority (SETA), or when the grant recipient is a "welfare organisation".

Although it might appear that the changes had a significant effect on the financial position of the different entities involved, as well as on the total tax collections of government, the purpose of the investigation into the matter and the subsequent amendments to the law, was to ensure the most efficient and consistent financing of the activities of the different government bodies.

The 2005 amendments impacted on government's revenue and corresponding changes had to be made to expenditure to adjust the quantum of the grant amounts to ensure that the effect of any potential change to the net financial position of the different government bodies and the total tax collections of government were minimised.

**2.4 National and provincial departments and public entities (Schedules 1, 2 and 3 of the PSA and Schedules 3A and 3C of the PFMA)**

The VAT treatment of appropriations made to national and provincial departments were not really affected by the 2005 amendments. As such, the appropriations continued to be treated as outside the scope of VAT where the entity concerned does not make supplies which are in competition with other vendors in the private sector (see **2.5**). The amendments did, however, clarify that national and provincial public entities listed in Parts A and C of Schedule 3 to the PFMA, should be treated on the same basis as national and provincial departments, as the supplies by these entities generally involve activities of a regulatory, administrative, stewardship or social nature. As such, they are generally not in competition with other vendors and are not the same or similar to taxable supplies made by other vendors. Public entities listed in Parts A and C of Schedule 3 to the PFMA that had registered for VAT without being notified by the Commissioner were therefore required to deregister with effect from 1 April 2005.

**2.5 Taxable or partially taxable national and provincial departments and public entities (Schedules 1, 2 and 3 of the PSA and Schedules 3A and 3C of the PFMA)**

If the Minister is satisfied that a department or public entity in **2.4** (that is, a "public authority") makes supplies which are of the same kind or similar to taxable supplies made in competition with other vendors, that specific activity may be regarded as an "enterprise" activity. Pursuant to a decision by the Minister in that regard, the department or public entity must be notified by the Commissioner to register for VAT in respect of that activity and is regarded as a "designated entity" to that extent. The VAT registration may apply to all the activities conducted by that entity, or only for specific activities (as the case may be). Certain public authorities that fell into this category (whether registered or not) were subsequently notified by the Commissioner to register as an enterprise in respect of some, or all, of their activities with effect from 1 April 2005 or subsequent to that date.

**2.6 Constitutional institutions (Schedule 1 to the PFMA)**

The activities of constitutional institutions are excluded entirely from the definition of "enterprise" as they are not of a commercial nature. As such, the law envisages that constitutional institutions will never carry on any activities in competition with any other vendor in the private sector, or become liable to register for VAT. Any constitutional institutions that were registered for VAT before the 2005 amendments were required to deregister with effect from 1 April 2005.

### 2.7 Major public entities (Schedule 2 to the PFMA)

The activities of major public entities such as ESKOM, Transnet Ltd, South African Airways and Telkom SA Ltd (or any of their subsidiaries) fall within paragraph (*a*) of the definition of "enterprise", and they will generally be required to register and account for VAT at the standard rate. As these are entities in which government has a commercial interest, any organisational subsidy (grant) from the government is deemed for VAT purposes to be consideration received for a taxable supply of services. As major public entities fall within the definition of "designated entity", the deemed supply which arises as a result of such receipts from government will generally be subject to VAT at the standard rate. This is to ensure that major public entities do not have an unfair advantage over their commercial competitors.

### 2.8 National and provincial government business enterprises (Schedules 3B and 3D of the PFMA)

National and provincial government business enterprises also fall within the definition of "designated entity", and their activities generally fall within paragraph (*a*) of the definition of "enterprise". The VAT treatment of national and provincial government business enterprises is therefore the same as the major public entities in **2.7**. The deemed supply which arises as a result of any organisational subsidy or grant payment received from government will therefore generally be subject to VAT at the standard rate.

### 2.9 Public private partnerships (Regulation 16 of the Treasury Regulations – section 76 of the PFMA)

A "public private partnerships" (PPP) (as defined in Treasury Regulations) is essentially a long-term contract between government and the private sector to carry on certain activities jointly. The activities of the participants in the PPP will fall within the normal enterprise rules in paragraph (*a*) of the definition of "enterprise". The participants in a PPP will also fall within the definition of a "designated entity", and will be treated for VAT purposes in the same way as the entities mentioned in **2.7** and **2.8**. Payments to PPP participants are generally subject to VAT at the standard rate, unless the payment is made to the PPP in connection with exempt supplies as contemplated in section 12.

### 2.10 Welfare organisations

The 2005 amendments did not really change the pre-April 2005 VAT treatment of a "welfare organisation". There were, however, two amendments which had a minor effect. The first is that a welfare organisation was included in the definition of "designated entity". Secondly, textual amendments were made to the wording of section 11(2)(*n*). The effect was that certain payments made to a "welfare organisation" (as defined) could continue to be zero-rated, as was the case under the previous wording of the VAT Act. However, the zero-rating under section 11(2)(*n*) only applies in the case of a **deemed supply of services**. A deemed supply can only arise if the payment concerned does not constitute consideration for an actual supply of goods or services under section 7(1)(*a*). The inference, therefore, is that the payment concerned must be unrequited.

## 2.11 Municipalities

Supplies of goods and services by municipalities such as electricity, water, gas and removal of refuse or sewage, are subject to VAT at the standard rate. Input tax may therefore be deducted on any goods or services acquired to make those supplies. However, any VAT incurred which is directly attributable to a municipality's non-enterprise activities may not be deducted and any VAT which is incurred for mixed purposes (both taxable and non-taxable purposes) must be apportioned.

As a "municipality" is not a "public authority" as defined in section 1(1), the 2005 amendments only affected municipalities to the extent that they receive and make grants. For example, the amendments clarified that to the extent an equitable share grant is received for taxable purposes by a municipality under the DOR Act, the deemed supply which arises in that regard is subject to VAT at the zero-rate.[7]

Similarly, a gratuitous payment which qualifies as a "grant" made by a municipality to another vendor which is for the purpose of subsidising or supporting that vendor's taxable (enterprise) activities will be zero-rated in the hands of that vendor. This would not have been the case before the 2005 amendments, as only a "public authority" could make a zero-rated "transfer payment".

**Example 1 – Deemed supplies vs actual supplies made by a municipality**

If a department (public authority) pays a municipality for the supply of electricity and water used in the course of conducting that department's operations, the amount paid is not a grant, as it is in respect of an actual supply of goods or services by the municipality to that department. However, if that same municipality receives an "equitable share" grant from National Treasury in terms of the DOR Act for the purpose of supplying free basic services (water, electricity and refuse removal) to indigent domestic consumers, that payment will constitute a "grant" in the hands of the municipality.[8] This is because the department does not receive a supply of goods or services in return for the payment made to the municipality.

The effect is that the supply of water by the municipality to domestic consumers (which is a taxable supply), is partly subsidised by the "equitable share" paid by the government. Therefore, to the extent that the "equitable share" is paid to the municipality to enable or assist it to make taxable supplies, the payment will constitute a "grant" and will be subject to VAT at the zero rate. The payment of equitable share by National Treasury is an institutional grant to the municipality which is provided in terms of the Constitution of the Republic of South Africa, Act 108 of 1996, and is not to be treated as payment of consideration on behalf of customers receiving free basic services.

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7 See sections 8(5A) and 11(2)(*t*).

8 This example applies on or after 1 April 2005. Before 1 April 2005, payments in terms of the DOR Act were not specifically dealt with in the VAT Act. As such a payment was not a "transfer payment" as defined, it would not have qualified for the zero rate in terms of section 11(2)(*p*).

## 2.12 Private vendors (not being designated entities)

Even before the 2005 amendments, it was always a requirement that an unrequited payment from government such as a "transfer payment" or "grant" can only qualify as a zero-rated receipt in the hands of the recipient vendor if the amount received does not constitute "consideration" for an actual supply of goods or services made by that vendor under section 7(1)(*a*). Unrequited or gratuitous payments made by other entities were not subject to the zero-rating under section 11(2)(*p*) before 1 April 2005 because only a "public authority" (as defined at the time) could make a "transfer payment". The 2005 amendments introduced the term "grant" and the zero-rating under section 11(2)(*t*) as a replacement for the term "transfer payment" and the zero-rating under section 11(2)(*p*) with effect from 1 April 2005. This had the effect of providing more certainty as to whether a particular payment was unrequited or not, and as a result, whether such payment qualified for zero-rating or not.

Unlike a "transfer payment" which could only be made by a public authority, a "grant" can be made by a public authority, constitutional institution or municipality. However, the principle still remains that a payment (even if it has been called a "grant") cannot qualify as a zero-rated receipt in the hands of the recipient vendor if that payment constitutes "consideration" for an actual supply of goods or services made by that vendor under section 7(1)(*a*). Such payments are not considered to be unrequited and can therefore not give rise to a deemed supply of services which is zero-rated under section 11(2)(*t*).

This includes a situation where payment is made for actual standard-rated taxable supplies procured by –

- the person making the payment; or
- the grantee, in a situation where payment of the consideration for the goods or services is made directly to a third party supplier of goods or services on behalf of the grantee.

**Example 2 – Deemed supplies vs actual supplies – research**

The Department of Trade and Industry (dti) allocates a certain amount of public funds each year to the National Research Foundation (NRF), for the funding of innovation and other initiatives.

The NRF is listed in Schedule 3A of the PFMA, and it is therefore a "public authority". Any payment received from the NRF by a vendor (not being a "designated entity") is deemed to be consideration in respect of a supply of services under section 8(5A) and will qualify as a zero-rated "grant" under section 11(2)(*t*). This is provided that the NRF or the dti does not acquire the ownership of any assets (including intellectual property rights) and does not receive any other goods or services (for example, actual research outputs) in return for the payment to that vendor. In other words, the receipt can only constitute a zero-rated grant if it does not constitute payment of consideration to that vendor for the reciprocal taxable supply of actual research services.

### 2.13 Special cases (unlisted entities)

Section 47 of the PFMA reads as follows regarding unlisted public entities:

> (1) The Minister, by notice in the national *Government Gazette*—
>
> (*a*) must amend Schedule 3 to include in the list all public entities that are not listed; and
>
> (*b*) may make technical changes to the list.
>
> (2) The accounting authority for a public entity that is not listed in either Schedule 2 or 3 must, without delay, notify the National Treasury, in writing, that the public entity is not listed.
>
> (3) Subsection (2) does not apply to an unlisted public entity that is a subsidiary of a public entity, whether the latter entity is listed or not.
>
> (4) The Minister may not list the following institutions in Schedule 3:
>
> (*a*) A constitutional institution, the South African Reserve Bank and the Auditor-General;
>
> (*b*) any public institution which functions outside the sphere of national or provincial government; and
>
> (*c*) any institution of higher education.

This means that the following are special cases which do not fall naturally into any of the categories dealt with in **2.4** to **2.11**:

- The South African Reserve Bank and the Auditor-General
- Entities in the process of being created and listed (see **5.5** for more details)
- Any public institution which functions outside the sphere of national or provincial government
- Any institution of higher education

It follows that the South African Reserve Bank and the Auditor-General are regarded as normal enterprises under paragraph (*a*) of the definition of “enterprise”. The same principle will apply to the entities in (ii), (iii) and (iv) above, to the extent that they may be regarded as making taxable supplies (unless the Minister decides otherwise).

## 3. The law

### 3.1 The period before 1 April 2005

The relevant provisions as they read immediately before the 2005 amendments are quoted in **Annexure A – Part 1**. The wording of these provisions is analysed and interpreted in detail in issue 2 of this Note. Certain explanations will, however, be retained with regard to the pre-April 2005 where it is deemed necessary to augment the understanding of any particular aspect dealt with in this Note.

### 3.2 The period on or after 1 April 2005

The relevant provisions quoted in **Annexure A – Part 2** are analysed and interpreted in **4.1** to **4.13**.

## 4. Application of the law

### 4.1 Definition of "enterprise" [paragraph (*b*)(i)]

Paragraph (*b*)(i) of "enterprise" refers to the supplies made by public authorities and identifies the different types of supplies which are similar to, or which compete with, taxable supplies made by any other vendor under paragraph (*a*) of the definition of "enterprise". In the case of public authorities, this business rationale, or business test, forms an integral part of the thinking behind the notification process. The intention is that the activities concerned should be conducted as far as possible with normal business principles and motivations in mind. This will include, for example, the assumption that the activity will at least be self-sustaining so that that the costs incurred to conduct the activity will be less than the income generated once the business infrastructure is in place.

The entities referred to in paragraph (*b*)(i) of the definition of "enterprise" exist so that the regulatory, administrative, stewardship or social function of national and provincial government can be carried out. As such, the supplies are not normally of the same type or nature found in the private sector, nor are they in competition with vendors in that sector.

In order for the supplies under this sub-paragraph to be treated as "enterprise" activities, the public authority concerned must be notified to register for VAT by the Commissioner, acting on instruction from the Minister. The Minister, in turn, must be satisfied that the supplies (or certain of them) are of the same kind or similar to taxable supplies already being made, or which might be made by vendors in the private sector.

Although the 2005 amendments did not affect the wording of paragraph (*b*)(i) of the definition of "enterprise", the application of this provision changed because of the amendment to the definition of a "public authority" which now includes certain public entities listed in the PFMA. Before the 2005 amendments, it was not clear whether certain public entities would be liable to register under paragraph (*a*) of the definition of "enterprise", or if paragraph (*b*)(i) of the definition applied. The 2005 amendments therefore clarified that the activities of national and provincial public entities listed in Parts A or C of Schedule 3 to the PFMA (non-business type classification) fell within paragraph (*b*)(i) of the definition of "enterprise" as these entities are regarded as public authorities with effect from 1 April 2005. (See explanation on the definition of "public authority" in **4.5**.)

As a result of the 2005 amendments, a few public authorities were notified to register for VAT with effect from 1 April 2005, or later (as the case may be). A further result was that public authorities and public entities listed in Parts A or C of Schedule 3 to the PFMA which were registered before 1 April 2005 were required to deregister with effect from the said date. Relief from the output tax normally due on this taxable event was provided to these entities (see **4.8**).

The activities of PPPs or other joint business ventures between government and private entities fall within paragraph (*a*) of the definition of "enterprise" and not paragraph (*b*)(i).

The VAT status of an entity may be affected if it has not yet been classified or is re-classified by the Minister in terms of the PFMA. Usually the effective date of the classification or re-classification as published in the *Government Gazette* will be the

date of liability, or the date on which the liability to register for VAT purposes ceases (as the case may be). However, in certain cases National Treasury and SARS may determine another date to be the effective date of liability which is reasonable in the circumstances, taking into account all the relevant circumstances and conditions prevailing for that entity (or other entities in a similar position).

One of the implications of the 2005 amendments was that certain PFMA entities that were registered for VAT before 1 April 2005 would no longer include VAT in any levy, duty or similar charge which they would be entitled to levy from 1 April 2005. For example, Skills Development Levy (SDL) charged in terms of the Skills Development Levies Act, 1999, no longer includes VAT. Vendors would therefore not be entitled to deduct any input tax in that regard from 1 April 2005.

### 4.2 Definition of "enterprise" [proviso (viii)]

The 2005 amendments saw the insertion of proviso (viii) to the definition of "enterprise" to exclude a constitutional institution listed in Schedule 1 to the PFMA. Constitutional institutions are now treated similar to public authorities in that their activities are not enterprise activities. However, the difference is that –

- a constitutional institution is not included in the definition of "public authority" in section 1(1); and
- the activities of constitutional institutions are excluded entirely from the definition of "enterprise". Their activities can therefore never fall within the ambit of the VAT Act, and they may not register for VAT.

Constitutional institutions which were registered before 1 April 2005 were deregistered from 1 April 2005. (See **4.8**.)

### 4.3 Definition of "designated entity"

The definition of a "designated entity" was introduced with effect from 1 April 2005.

A designated entity is a specific kind of vendor, namely –

- a "public authority" which is registered for VAT under paragraph (*b*)(i) of "enterprise" (only to that extent); or
- a major public entity listed in Schedule 2 to the PFMA; or
- a national government business enterprise or provincial government business enterprise listed in either Part B or D of Schedule 3 to the PFMA; or
- a "PPP" as defined in the PFMA and the Treasury Regulations; or
- a "welfare organisation"; or
- a "municipal entity" (as defined in section 1 of the Local Government: Municipal Systems Act 32 of 2000);[9] or
- an entity which has powers similar to those of any water board listed in Part B of Schedule 3 of the PFMA, where that entity would have also complied with the definition of "local authority" before the deletion of that definition on 1 July 2006.

[9] Municipal entities were included in the definition with effect from 1 July 2006.

Designated entities are entities in which government has an interest. Government may therefore assist a designated entity by funding their activities either on an ongoing basis, or from time-to-time, as required. For example, government may be the majority or sole shareholder in a major public entity, or the entity might be involved in delivering public goods and services which are in competition with other vendors. Designated entities are therefore identified as service providers to government to the extent that the payment is in respect of taxable supplies made to the public. (See application of section 8(5) in **4.9**.)

As the deeming provision in section 8(5) was amended so that it now only applies to designated entities, any payment such as an institutional subsidy paid by a public authority to assist a designated entity to carry on its enterprise activities is subject to VAT at the standard rate with effect from 1 April 2005. There are, however, two exceptions when the **deemed supply** which arises in the hands of a designated entity will qualify to be taxed at the zero rate, namely –

(a) when a gratuitous payment is made to a welfare organisation – in which case the zero rate under section 11(2)(*n*) will apply; and

(b) when a "grant" (as defined) is paid to the designated entity under section 10(1)(*f*) of the Skills Development Act 97 of 1998 for training its employees – in which case the zero rate under section 11(2)(*u*) will apply.

### 4.4 Definitions of "local authority" and "municipality"

The term "local authority" was previously defined in the VAT Act. The term was fairly wide and included a number of different entities such as Joint Services Boards, Regional Services Councils and various other councils and boards that would not qualify as a "municipality".[10] This term "local authority" was deleted and replaced with the definition of "municipality" (which is a much narrower term) with effect from 1 July 2006.

A "municipality" is regarded as part of the third tier of government – sometimes referred to as "local government". The purpose of local government is essentially to decentralise certain functions of government so that the local community can have more control over the governance issues which impact on their daily lives in the regions in which they live.

The term "municipality" is dealt with in this Note only to the extent that it is necessary to deal with the VAT treatment of grants which are received by and made by municipalities and to clarify that a municipality is not a "public authority (as defined).

For further information on the VAT treatment of municipalities see the *VAT 419 – Guide for Municipalities*.

[10] The Municipal Demarcation Board established by section 3 of The Local Government: Municipal Demarcation Act, 1998 is responsible for determining municipal boundaries and district management areas.

### 4.5 Definition of "public authority"

It is important to know whether a particular entity is regarded as a public authority for VAT purposes for two main reasons:

(a) A "public authority" must be notified to register for VAT under paragraph (*b*)(i) of the definition of "enterprise". In a case where an entity does not fall within the definition of a "public authority", the normal rules under paragraph (*a*) of the definition of "enterprise" apply in that no notification by the Commissioner regarding the liability to register is required; and

(b) A "public authority" is one of the entities that can make a "grant" to a vendor. It follows that the zero rate under section 11(2)(*t*) can only apply if the deemed supply that arises, is as a result of a grant payment received from one of the entities mentioned in section 8(5A), namely, a public authority, constitutional institution or municipality.

As the defining line between public authorities and public entities became somewhat blurred over the years, uncertainty was created as to the VAT status of certain public entities (that is, the distinction between government "departments" and other government "agencies" was unclear). This was mainly because the terms "department", "division of the public service", and "provincial administration" mentioned in the pre-April 2005 definition of "public authority" were not defined for VAT purposes.

Before the 2005 amendments, to determine if an entity was a "public authority", one had to examine the aims of various Acts to determine (amongst others), the nature, functions, powers, financing, reporting structures and responsibilities of the organisation. Some of the important sources of information included the PSA, the PFMA and section 40(1) of the Constitution of the Republic of South Africa, Act 108 of 1996.

Based on the above, the position before 1 April 2005 a "public authority" only included those departments listed in Schedules 1, 2 or 3 of the PSA.[11] However, as a result of certain changes within government structures as explained in **2.2** and **2.3** the policy is that the term "public authority" should also include public entities which conduct non-business activities such as the regulatory, administrative, stewardship or social functions of the first two tiers of government.

The definition of ''public authority" was therefore amended with effect from 1 April 2005 to clarify that the following entities fall within the ambit of the definition:

> "(i) any department or division of the public service as listed in Schedules 1, 2 or 3 of the Public Service Act, 1994 103 of 1994; or
>
> (ii) any public entity listed in Part A or C of Schedule 3 to the Public Finance Management Act 1 of 1999; or
>
> (iii) any other public entity designated by the Minister for the purposes of this Act to be a public authority."

[11] See **Annexure B**.

Entities that are **included** in definition of "public authority" can therefore be summarised as follows:

- Entities listed in Parts A and C of Schedule 3 to the PFMA (including any subsidiary or entity under the ownership control of that entity);
- All the national and provincial government departments listed in Schedules 1, 2 or 3 of the PSA (including any branches, divisions, trading accounts, local offices and other components of that department); and
- Certain other entities which should be regarded as public authorities. This was introduced primarily to address transitional situations such as –
  - newly created public entities in the process of being classified;
  - entities in the process of being re-classified in terms of the PFMA; and
  - entities that disagree with their classification under the PFMA and intend to apply for re-classification (or which have already applied to be re-classified), provided the Minister agrees with the classification as a "public authority" for VAT purposes.

Entities that are **excluded** from the definition of "public authority" are summarised as follows:

- Constitutional institutions listed in Schedule 1 to the PFMA;
- National or provincial government business entities listed in Parts B and D of Schedule 3 to the PFMA;
- Major public entities listed in Schedule 2 to the PFMA;
- Entities that are party to a public private partnership (PPP);
- Municipalities and municipal entities; and
- Any institution of higher education.

### 4.6 Definition of "services"

The term "services" means 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. The definition is meant to be as broad and all-inclusive as possible, but it excludes "goods" and "money" as defined in section 1(1). Therefore, if a particular transaction does not constitute a supply of "goods" or "money", it should generally fall within the definition of "services".

In order to fall within the scope of the VAT Act, a payment (consideration) must be received by a vendor in respect of a taxable "supply" made by that person. This can be an actual supply, or any event that the VAT Act deems to be a supply in certain circumstances (deemed supply). It follows that a donation will not be subject to VAT as such a payment is given unconditionally and does not constitute payment for any supply of goods or services to the donor. The VAT Act does not deem a supply of services to have been made to the donor by the donee when a donation is received. It is also worth noting that in our law, there is a presumption against the making of a donation unless the facts and circumstances indicate the contrary.[12] A person is therefore presumed not to have paid an amount of money to another person, or to

[12] Refer for example, to *Myers v Lesch* 1954 (2) SA 487 (T) and *Jepson NO v Lezar* (6453/2007) [2009] ZAFSHC 49.

have supplied goods or services to that person without some form of *quid pro quo* (mutual consideration, equal exchange, or something given in return for that which is received).

Similarly, to qualify as a "grant" (as defined), it is a requirement that there is no reciprocal (actual) supply of goods or services by the vendor in return for the payment. In other words, there is no supply made by the vendor because of the unrequited nature of a grant. However, unlike in the case of a donation, the VAT Act **deems there to be a supply of "<u>services</u>"** by a vendor to the public authority, municipality or constitutional institution making the grant payment.

The deeming provision in section 8(5A) is a necessary construct of the VAT Act because the zero rate of VAT under section 11(2)(*t*) can only apply when there is a taxable "supply" of "services". [See **4.10** and **4.11.2** regarding the application of sections 8(5A) and 11(2)(*t*).] Had it not been for the deeming provision, the unrequited grant payment would have been out-of-scope for VAT purposes and not zero-rated. Similarly, the deeming provision in section 8(5) is necessary to ensure that payments by government to designated entities are in respect of a taxable "supply" of "services" which is subject to VAT at the standard rate. (See **4.9** regarding the application of section 8(5).)

One of the main issues with the application of the law in this regard is that public authorities and municipalities sometimes incorrectly assume that certain payments made to vendors are zero-rated because the goods or services procured are for the delivery of government services and assistance programmes to the public. However, as such payments constitute consideration for the **actual acquisition of goods or services** by the public authority or municipality concerned, they are subject to VAT at the standard rate in accordance with the normal rules under section 7(1)(*a*). There is therefore no deemed supply of services which arises when a public authority or municipality procures goods or services from suppliers. Further, section 86 requires that the State is subject to the provisions of the VAT Act, meaning that VAT is a cost to the State in the case of a public authority that has not been notified to register as an enterprise.

In the absence of a written contract, it is sometimes difficult to establish if there is a sufficiently strong link between a particular payment and the specific performance of any identifiable services in return for that payment. The position is more clear-cut when it involves the supply of goods, but subjective differences in perception of the parties to a transaction may cloud the issue as to whether actual goods or services are supplied under a contract, or if a deemed supply of services arises as a result of a grant being received. These sorts of subjective differences in perception can only be resolved by an objective analysis of the written contract (if any) and any surrounding facts and circumstances relating to the matter within the tax policy framework which is explained in this Note and the relevant provisions of the VAT Act.

**Example 3 – Different perceptions in regard to certain payments from government**

Consider a payment made by a government department to a vendor as an incentive for innovation in developing or manufacturing South African produced goods. The possible perceptions of the parties to the transaction could be any of the following:

- The department may have perceived that the vendor was supplying a valuable service, in that it assisted that department to fulfil its mandate in meeting the country's economic objectives. However, the vendor's view may be that there was no link between the payment and any specific identifiable service supplied in return to that department; or
- The vendor might have viewed the payment as consideration for conducting the enterprise in a particular manner which was intended to compensate for the possible sacrifice of other business opportunities. On the other hand, the department's view may be that it was distributing the funds to that vendor as well as many others as part of its (benevolent) mandate, and therefore, the vendor did not really supply any specific, identifiable or valuable service to the department in return; or
- Neither party perceived that there was a service supplied in return for the payment; or
- Both parties regarded the payment as being consideration in respect of an actual (specific) service supplied by the vendor to the public authority.

### 4.7 Definitions of "transfer payment" and "grant"

As previously mentioned, various attempts were made before 1 April 2005 to clarify the meaning of the term "transfer payment" [and hence the application of the zero-rating under section 11(2)(*p*)]. Part of the difficulty with the meaning of the term "transfer payment" and the associated zero-rating under section 11(2)(*p*) was that it did not include payments such as equitable share grants, municipal infrastructure grants or any other appropriation paid in terms of the DOR Act before 1 April 2005.[13] Certain unrequited payments made by entities such as those listed in Parts A and C of Schedule 3 to the PFMA were also not included.

In order to overcome these difficulties, the 2005 amendments deleted the definition of "transfer payment" and the zero-rating under section 11(2)(*p*). Those provisions were replaced by the definition of "grant" and the zero-rating under section 11(2)(*t*) with effect from 1 April 2005. Textual amendments were also made to section 8(5) to provide a deeming provision which would apply specifically to payments made to **designated entities**. The effect being that such payments would generally be standard rated in the hands of designated entities and that the zero-rating under section 11(2)(*t*) would not apply. (See **4.9**.)

[13] Section 40A was introduced to provide relief in the case of certain assessments raised because of this incorrect treatment. Section 40A has since been deleted.

At the same time, section 8(5A) was introduced to deem a private vendor to make a taxable supply of services to the public authority, constitutional institution or municipality if that entity paid a grant to that vendor in the course or furtherance of carrying on an enterprise. In this way, the **deemed supply of services** which arises in the hands of a private vendor (not being a "designated entity") as a result of the receipt of the grant from a public authority, constitutional institution or municipality, will be zero-rated under section 11(2)(*t*). (See **4.10**.)

The term "grant" is split into two main parts as described below.

The first part describes in general terms which types of payments will qualify as a "grant" as follows:

> "[M]eans any appropriation, grant in aid, subsidy or contribution transferred, granted or paid to a vendor by a public authority, municipality or constitutional institution."

The use of the words "appropriation", "grant in aid" and "subsidy", indicate that the receipt constitutes assistance from the state (usually in the form of money). In other words, it is a gratuitous or "unrequited" payment by the grantor, where no reciprocity is expected from the recipient in the form of a supply of goods or services of corresponding value.

When the recipient is required to perform minor actions in regard to the grant, such as providing the grantor with information on how the funds were spent, or reporting on how goods or services granted were applied, these actions are not regarded as constituting a taxable supply of "services" by the grantee to the grantor under section 7(1)(*a*). However, if a public authority engages a service provider to supply a specific service in return for the payment, that payment is not a "grant" as defined. A grant also excludes financial assistance in the form of a loan where, and to the extent, that the amount must be repaid to the lender (grantor) either in the form of money, or in the form of a supply of goods or services.

Sometimes it can be quite difficult to distinguish between a grant and a payment for goods or services supplied, as the perceptions of the parties are not always in alignment, especially when there is no written document which attempts to address the duties and responsibilities of the parties. Even in the case where there is a written document, the parties should be careful not to form an opinion on this point, based exclusively on the ordinary meaning of certain words used in the document. For example, if the word "grant" is used to describe the payments to be made in terms of a "grant contract", the word "grant" might be interpreted to have different meanings. This will depend on the context of the contract, the specific deliverables which are required under the contract (if any), and the perceptions of the parties regarding those deliverables. Furthermore, a "grant" is specifically defined for VAT purposes. The defined meaning is therefore more important than the ordinary meaning when determining the VAT consequences of any transaction (supply) which arises under, or as a consequence of, the grant contract. The mere use of the word "grant" in the contract does not necessarily mean that the payments concerned will qualify as such for VAT purposes.[14]

[14] Drafters of such contracts should therefore pay careful attention to the words used to describe the different kinds of payments made in terms of the contract. Also, caution should be exercised when using generic or template agreements which might not be appropriate in the circumstances.

**Example 4 – Grant vs consideration for the acquisition of actual services**

The Department of Transport (DoT) engages a private research consultant to conduct a market survey on the public perceptions of the introduction of new legislation pertaining to the taxi industry.

As the department has directly procured the services of the vendor for its own purposes, the activities involved in conducting the research and presenting the research findings to the department do not constitute a statement of how grant funds were spent. The payment in this regard is therefore consideration for the actual supply of services which is subject to VAT at the standard rate. The payment cannot qualify as a zero-rated "grant", even if the payments under the contract have been described as grant payments, as the facts show that the DoT commissioned the research work for its own benefit and that the payments made under the contract were not gratuitous or unrequited.

The second part of the definition of "grant" is also split into two main parts, namely, paragraphs (*a*) and (*b*). These paragraphs provide for exclusions from the meaning of "grant".

The first part of paragraph (*a*) reads as follows:

> "…but does not include—
>
> (*a*) a payment made for the supply of any goods or services to that public authority or municipality, **including** … in accordance with a procurement process prescribed—
>
> (i) …
>
> (ii) …
>
> (*b*) …"

This part of the definition is essentially a "procurement" test which specifically excludes payment for the actual supply of goods or services acquired by a public authority, municipality or constitutional institution through their usual respective procurement procedures. This refers especially to the capital or operating expenditure incurred by a public authority, municipality, or constitutional institution for own consumption in conducting their activities.

These expense items should fall under the budget headings *"Current payments"* or *"Payments for capital assets"* of that entity. However, an incorrect classification under other headings such as *"Transfers and subsidies to:"* other entities does not mean that the payments will automatically be treated as zero-rated grant payments under section 11(2)(*t*). The true nature of the payments concerned (and hence the VAT treatment the payments) will be established based on the facts and circumstances under which the payments are made.

The use of the word "including" in the statement *"…**including** …in accordance with a procurement procedure…"* also recognises the possibility that goods or services may be acquired in circumstances where the prescribed procurement procedures might not apply. In each instance it must be established if the amount was paid in respect of the actual acquisition of any goods or services or not.

Further, when the grantor pays a supplier of goods or services directly on behalf of the grantee, this does not mean that the supplier may charge the zero rate on the supply made to the grantee. In such cases, the grantee is still deemed to make a zero-rated supply of services to the grantor in respect of the payment, but the supplier must charge VAT on the actual supply at the standard rate (if it is a taxable supply), and issue a tax invoice to the recipient.

**Example 5 – Procurements not qualifying as grant payments**

- Office supplies paid for out of petty cash where the formal procurement procedure does not apply.
- Funds paid to a vendor in terms of a so-called "grant contract" and included under a budget item headed "Transfers and subsidies to:", but where part of the funds must be used to purchase fixed assets and create intellectual property which becomes the property of the so-called "grantor".
- Any other payment which is incorrectly classified by a public authority as a "grant", where, in substance, the amount represents payment for the actual supply of goods or services which are to be consumed by the public authority making that payment, or for an actual supply to a third party on the instruction of the so-called "grantor".

Sub-paragraphs (i) and (ii) of paragraph (*a*) of the definition of "grant" go on to elaborate in regard to the general exclusion contemplated in paragraph (*a*) as follows:

> "…but does not include—
>
> (a) …
>
> (i) in terms of the Regulations issued under section 76(4)(c) of the Public Finance…; or
>
> (ii) in terms of Chapter 11 of the Local Government: Municipal Finance Management Act, 2003 56 of 2003, **or any other similar process**; or…"

All public entities are required to procure goods and services in accordance with the PFMA Regulations. This is essentially covered by the Regulatory Framework for Supply Chain Management (SCM)[15] which applies to all national and provincial departments and trading entities, constitutional institutions and public entities listed in Schedules 3A and 3C to the PFMA. It will also include reference to any deviations which may be allowed from the SCM as a result of the phasing in of those procedures under Treasury Regulation 16A12, or as otherwise required under section 38(1)(*j*) of the PFMA.

The MFMA generally applies to municipalities in the same way that the PFMA applies to public authorities. As the procurement procedure as set out in Chapter 11 of the MFMA was being phased in at the time that the VAT law was amended in 2005 and 2006, those procedures only applied to certain municipalities at the time. Municipalities are, however, now expected to apply SCM which is supported by, amongst others, Chapter 11 Part 1 of the MFMA, the Municipal SCM Regulations issued under the MFMA, the Municipal SCM Model Policy and other documents such as practice notes and circulars issued by National Treasury in this regard.

[15] See National Treasury's website **www.treasury.gov.za** for more information.

Sub-paragraphs (i) and (ii) of paragraph (*a*) of the definition of "grant" are therefore exclusionary provisions. They essentially exclude a payment from qualifying as a grant when public authorities, public entities and municipalities acquire goods and services under their normal procurement processes. However, these are not the only exclusions.[16]

The use of the words ***"or any other similar process"*** in paragraph (*a*)(ii) of the definition is intended to have a similar effect in the case of municipalities as was explained above with regard to the function of the word "including" in the first part of paragraph (*a*). This means that in the case of both public authorities and municipalities, any payment made in connection with the acquisition of actual goods or services does not fall within the meaning of "grant", whether the official procurement methods were followed or not. Consequently, any form of *quid pro quo* (consideration) which can be linked to an actual supply of goods or services made to the public authority, constitutional institution or municipality making the payment, or which has been paid for by that entity on behalf of a third party beneficiary, cannot constitute a "grant" as defined.

A further issue is that the labelling of payments under legal provisions such as section 67 of the MFMA which allows municipalities to make gratuitous payments, for example, to public benefit organisations in certain circumstances, cannot be used as a way of circumventing the definition of "grant". For example, words such as "grant", "subsidy", "grant in aid" or "intergovernmental grant" are sometimes used in a contract to describe payments made to the contracting party to perform activities which have been outsourced or subcontracted out by a municipality. Whether the supplies are contractually made to the municipality that makes the payment, or to a third party beneficiary, in either case, the payment is not gratuitous or unrequited and will not meet the definition of "grant".

It follows that it cannot be assumed that a payment which is said to have been made under section 67 of the MFMA is automatically zero-rated for VAT purposes merely because it has been called a grant. Each case must be tested to establish whether the recipient is required to supply any goods or services in return for the payment. The same reasoning will apply to any outsourcing or subcontracting arrangement involving a public authority.

Paragraph (*b*) of the definition of "grant" contains a further exclusion as follows:

> "…but does not include—
>
> (*a*) …
>
> (*b*) a payment contemplated in section 8(23); ."[17]

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[16] See the earlier explanation in **4.8** on the first part of paragraph (*a*) of the definition of "grant".

[17] With effect from 1 April, 2017 this paragraph will read as follows: *"(b) a payment made to or on behalf of a vendor in terms of the national housing programme contemplated in the Housing Act, 1997 (Act No. 107 of 1997)."*

### 4.8 Certain supplies of goods or services deemed to be made or not made upon ceasing to be a vendor [section 8(2) proviso (iv)]

Section 8(2) deems a vendor to supply the assets used for enterprise purposes when ceasing the enterprise. It requires that output tax be declared on the lesser of cost or open market value of those assets at the standard rate. However, proviso (iv) was inserted under section 8(2) to provide relief from the output tax which would otherwise have been payable by constitutional institutions and public authorities upon deregistration when the 2005 amendments came into effect from 1 April 2005.

Since this provision relates mainly to the pre-April 2005 period, it is not discussed further. For more information in this regard, see issue 2 of this Note which is available on the SARS website under the Legal Counsel archive.

### 4.9 Certain supplies of goods or services deemed to be made or not made by a designated entity upon receipt of a payment from a public authority or municipality [section 8(5)]

Before 1 April 2005, section 8(5) was a general deeming provision applicable to all vendors in regard to certain payments received from public authorities and municipalities. Part of the uncertainty in regard to the application of section 8(5) in the past, was that some vendors adopted the incorrect view that as long as the payment came from a public authority or municipality, the receipt was subject to VAT at the zero rate. The true effect of section 8(5) before the 2005 amendments was, however, that the recipient (being a vendor) was deemed to make a taxable supply of a service to the public authority or municipality making the payment. The payment would have been subject to VAT at the zero rate under section 11(2)(*p*) only if it was a "transfer payment" (as defined). However, as a "transfer payment" could only be made by a "public authority" before 1 April 2005, if the payment concerned was made by a municipality, the deemed supply which arose would have been subject to VAT at the standard rate.

The 2005 amendments saw the wording of section 8(5) amended in such a way that from 1 April 2005, it only applies to a "designated entity" (see **4.3**). The effect being that a designated entity would generally be liable to account for VAT at the standard rate on the deemed supply which arises as a result of the receipt of such payments. Section 8(5A) was also introduced at the same time to provide for a deemed supply of services to be made to a public authority, municipality or constitutional institution by a private vendor (not being a designated entity). The effect being that the deemed supply which arises under section 8(5A) is zero-rated under section 11(2)(*t*) when a private vendor receives a grant, whereas the standard rate applies in the case of the deemed supply which arises under section 8(5) when the recipient is a designated entity. (See also **4.9** and **4.10**.)

Individual phrases in section 8(5) (as amended) are explained below.

*For the purposes of this Act a designated entity shall be deemed to supply services to any public authority or municipality*

The deeming provision contained in section 8(5) is applicable for the purposes of the VAT Act as a whole. In other words, when any payment is made by a public authority or municipality to a designated entity, the recipient is deemed to supply a service to the person making the payment. However, when looking at the application of the VAT Act as a whole, there are a few instances when the deeming provision cannot apply, namely –

- when the payment constitutes consideration for any goods or services actually supplied by the designated entity to the public authority or municipality making the payment (or to a third party on the instruction of the public authority or municipality) – in which case the normal rules under section 7(1)(*a*) apply; or
- when the payment is not received by the designated entity for the purpose of carrying on its "enterprise", for example, if it constitutes consideration for the supply of shares or if it is a loan.

The earlier discussion in **4.6** regarding the difference between actual supplies and deemed supplies should be kept in mind here. The point being that no deemed supply will arise under section 8(5) when there is an actual supply of goods or services made to the public authority or municipality making the payment, or to another person on behalf of the public authority or municipality.

Since "services" means *"anything done or to be done…"* the payment can relate to enterprise activities conducted in the past, present or future.

*To the extent of any payment made by the public authority or municipality concerned*

The services are only deemed to be supplied when, and to the extent, that any payment was made by a public authority or municipality in connection with an "enterprise" carried on by the designated entity. This means, for example, that if a vendor qualified to receive funds for enterprise purposes and the amount was payable in tranches over a period of time, the deemed supply only arises at the time, and to the extent, that the payments were actually received by that vendor in the tax period concerned. The designated entity will therefore not necessarily have a liability to declare output tax on the full budgeted amount of the subsidy at the time that it was approved unless the full amount was also paid out to the designated entity during the same tax period.

**Example 6 – Innovation subsidy**

The Department of Science and Technology (public authority) pays a designated entity part of the R300 000 in respect of a subsidy programme which it has to support the research, design and creation of new products and methods to increase the production of disease-free chickens. The designated entity only makes taxable supplies and any new product, technology or methodology which is developed from the grant funding would remain the property of the designated entity.

Payment of R100 000 was made on 1 July 2014 and a further R200 000 will be paid to cover further development expenses and protection of intellectual property rights once actual evidence is produced that the product, technique, invention or methodology is viable in practice.

In this case, the vendor (designated entity) would have declared output tax at the standard rate on R100 000 in the tax period covering 1 July 2014. If the vendor received the balance of R200 000 on 15 November 2015, output tax on that amount would only be declared in the tax period in which 15 November 2015 falls, since the deemed supply is only made *"to the extent of any payment made by the public authority."* In this example, the designated entity is **deemed** to make a taxable supply of services to the Department as the payment does not relate to any actual supplies of goods or services made to the Department under section 7(1)(*a*), nor is the payment received in connection with any non-taxable activities conducted by the designated entity. The Department's intention in this case was generally to stimulate the creation and promotion of innovative products and methodologies in accordance with its constitutional mandate as a Department which is concerned with scientific innovation.

The Department is not regarded as having paid the designated entity to acquire any technology or invention for itself, as the designated entity retains the intellectual property rights and would be able to exploit those rights for its own benefit in the future.

*To or on behalf of that designated entity*

The payment does not necessarily have to be received by the designated entity itself. The payment could also be made on behalf of the designated entity to that person's agent, or other person who may apply the payment for the benefit of the designated entity. For example, the payment could be paid to a creditor to reduce or extinguishing a debt owed by the designated entity in respect of taxable supplies previously made by that person to the designated entity. See also the earlier comments regarding payments made directly to third parties.

*In the course or furtherance of an enterprise carried on by that designated entity*

A **deemed supply of services** by a designated entity will only arise under section 8(5) [provided the payment is not consideration in respect of an actual taxable supply under section 7(1)(a)] if the payment (or part of of the payment) is for taxable use in the enterprise. For example, if the total payment is a composite of amounts paid for subsiding the designated entity's taxable and non-taxable activities, only the amount which is attributed to the taxable (enterprise) activities constitutes the consideration for the deemed supply of services under section 8(5).

If the payment relates exclusively to exempt or other non-taxable activities carried on by the designated entity, then no deemed supply arises under section 8(5).

**Example 7 – Top-up payment for budgeting shortfall**

A major public entity (designated entity) realises that it is going to have a shortfall in the following financial year unless government contributes towards the demands of the trade unions representing their workers for a 10% salary increase. As it had only budgeted for a 5% salary increase, National Treasury agrees to make a once-off top-up payment to supplement the budget of the entity so that it can meet the shortfall.

Assuming the major public entity only makes taxable supplies, the entity is deemed to make a taxable supply of services to National Treasury under section 8(5) in respect of the full amount of the top-up to the extent that the payment was received in the tax period concerned. This rule applies regardless of the fact that when the designated entity spends the funds on increasing the salaries, that it will not be able to deduct any input tax in that regard.

**4.10 Certain supplies of goods or services deemed to be made or not made by a vendor (not being a "designated entity") upon receipt of a payment from a public authority, municipality or constitutional institution [section 8(5A)]**

Individual phrases in section 8(5A), are explained below.

*For the purposes of section 11(2)(t)*

Unlike section 8(5), which applies for the purposes of the VAT Act as a whole, section 8(5A) applies specifically for the purposes of the zero-rating provided for grant payments under section 11(2)(*t*).

*A vendor (excluding a designated entity) shall be deemed to supply services to any public authority, municipality or constitutional institution listed*

Since section 8(5) applies exclusively to designated entities from 1 April 2005, a similar provision in the form of section 8(5A) was introduced at the same time to create a deemed supply where a vendor (not being a designated entity) receives a grant. (See also **4.9**.)

The issue was that under the previous wording of the VAT Act, a "transfer payment" as defined would only qualify for the zero rate under section 11(2)(*p*), if the person making the payment was a "public authority". A similar subsidy or grant payment by a municipality or certain PFMA entities did not qualify for the zero-rating.

Section 8(5A) (through the amended definition of "public authority"), extends the deeming provision relating to grants [and hence the zero-rating provisions under section 11(2)(*t*)] to apply in respect of certain payments made by constitutional institutions and the additional entities which qualify from 1 April 2005 as public authorities (that is, public entities listed in Parts A and C of Schedule 3 to the PFMA). The purpose of this deeming provision is to bring a grant payment within the scope of the VAT Act so that the zero-rating under section 11(2)(*t*) can apply.

Section 8(5A) also includes grant payments made between any of the entities mentioned, for example, a grant from a department to a municipality, or from a Schedule 3A PFMA entity to a Schedule 3C PFMA entity. This is to cover the situation where the responsibility to approve and make grants available to the identified beneficiaries is devolved or assigned to another entity.

Section 8(5A) must be read with the zero-rating in section 11(2)(*t*). The requirements to be met under section 8(5A) are that –

- the payment must be made by a "public authority" (as defined), a "municipality" (as defined) or a "constitutional institution" as contemplated in Schedule 1 to the PFMA; **and**
- the payment must qualify as a "grant" (as defined) which is an unrequited payment.

Any gratuitous or unrequited payment by another type of entity, or a payment which does not meet the definition of "grant" will not qualify to taxed at the zero rate as contemplated in section 11(2)(*t*).

*To the extent of any grant paid to or on behalf of that vendor*

This term has the same meaning as explained in **4.9**. The only difference is that section 8(5A) refers to a "vendor" (meaning a private vendor that is not a designated entity), whereas section 8(5) refers to a vendor that is a "designated entity". As explained in **4.9**, a deemed supply which arises in the hands of a designated entity under section 8(5) does not link to any zero-rating as is the case under section 11(2)(*t*) which links specifically with section 8(5A).

*In the course or furtherance of an enterprise carried on by that vendor*

This term has the same meaning as explained in **4.9**. The only difference between that this part of section 8(5A) and the comparable part of section 8(5) is that section 8(5A) refers to a "vendor" (meaning a private vendor that is not a designated entity) whereas section 8(5) refers to a "designated entity" (which, by definition, must be a vendor).

### 4.11 Zero-rating – services [section 11(2)]

*Where, but for this section, a supply of services would be charged with tax at the rate referred to in section 7(1)*

Section 11(2) contains a list of services and the circumstances under which the zero rate of VAT is applicable. The supply being considered under this section must be of the type that would otherwise have been subject to the standard rate, had this provision not been in the VAT Act. The supply of any exempt services listed in section 12 or services otherwise than in the course or furtherance of an "enterprise" are therefore excluded. However, section 11(2) overrides sections 12(*a*) (international financial services) and 12(*g*) (international transportation services), so that these specific supplies are also included in the scope of application of this provision. In other words, they are not precluded from being zero-rated instead of exempt in certain cases.

*Such supply of services shall, subject to compliance with subsection (3) of this section*

As with all supplies mentioned in section 11, there is a condition that the vendor must obtain and retain documentary proof acceptable to the Commissioner which substantiates the application of the zero rate. (See Interpretation Note 31 (Issue 3) "Documentary Proof Required for the Zero-Rating of Goods and Services" for the prescribed documents.)

*Be charged with tax at the rate of zero per cent where*

The zero rate applies only where the specific circumstances mentioned in the various sub-paragraphs to section 11(2) are applicable. For example, for a payment to be zero-rated under section 11(2)(*n*), the various conditions set out in sub-paragraph (*n*) must be met as set out in **4.11.3**.

### 4.11.1 Zero-rated "transfer payment" [section 11(2)(*p*)]

This provision was deleted with effect from 1 April 2005. The application of the provision and the role that it played in the development of the law as it currently reads is discussed in detail in issue 2 of this Note which is available on the SARS website under the Legal Counsel archive.

### 4.11.2 Zero-rated "grant" [section 11(2)(*t*)]

*The services are deemed to be supplied in terms of section 8(5A)*

Essentially, this provision will apply where a private vendor (not being a "designated entity"),[18] receives some form of financial assistance or organisational subsidy from a public authority, municipality or a constitutional institution to assist that person in carrying on an enterprise. The zero-rating only applies where the amount is a "grant" (as defined) and where the deeming provisions of section 8(5A) apply in respect of the taxable activities of the enterprise. (See also **4.6**, **4.7**, **4.10** and **4.11.3**.)

The payment must not be in respect of the procurement of goods or services under section 7(1)(*a*) by a public authority, constitutional institution or municipality, or be a payment made under a national housing programme [the latter being dealt with under sections 8(23) and 11(2)(*s*).]

### 4.11.3 Zero-rated payments to welfare organisations [section 11(2)(*n*)]

As mentioned in **2.10**, the 2005 amendments to section 11(2)(*n*) were purely textual in nature. The changes were necessary because of the amendment to section 8(5) as well as the inclusion of a welfare organisation in the definition of "designated entity". (See **4.3**.) The effect is that although a welfare organisation is a "designated entity", the zero-rating in respect of the **deemed supply** which arises when certain payments are received to support the carrying on of taxable welfare activities will apply. The zero-rating under section 11(2)(*n*) is therefore an exception which applies when a **deemed supply** by a designated entity (being a welfare organisation) arises to the extent that the funds are received for the purpose of assisting that organisation to carry on its welfare activities (that is, its "enterprise"). In any other case, the deemed supply which arises under section 8(5) for any other type of designated entity would be subject to VAT at the standard rate as discussed in **4.9**.

In a case where the constitutional institution, public authority or municipality procures goods or services from a welfare organisation that is a vendor, there will be an **actual standard-rated taxable supply** under section 7(1)(*a*). As there is no **deemed supply** in such a case, the payment concerned is not zero-rated under this provision. (See also **4.9** and **4.10**.)

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[18] A "welfare organisation" is also a "designated entity", however, section 11(2)(*n*) will apply in the case of a welfare organisation and not section 11(2)(*t*).

This principle of deemed supplies vs actual supplies was at the heart of the matter in the case of *CSARS v Marshall NO* (816/2015) [2016] ZASCA 158 (3 October 2016). The question that the Supreme Court of Appeal (SCA) had to consider in this case was whether certain aero-medical services supplied by the respondent (being a welfare organisation) to provincial health departments constituted a "deemed supply" of services as contemplated in section 8(5), and consequently, whether payments received in respect of these services qualified to be zero-rated under section 11(2)(*n*). The SCA concluded as follows at paragraphs 34 and 35 of the judgment:

> "[34] In summary, the scheme of the VAT Act is such that generally, the supply of goods and services attracts an obligation to pay VAT at the standard rate of 14%. In certain instances a zero VAT rating is applicable where payment is not linked to an actual supply of goods and services. The deeming provision operates to create an imagined supply of goods and services, which may qualify for a zero rating. Already, grants and subsidies provide a substantial incentive for PBOs to supply goods and services on behalf of public authorities. Zero rating is the most favourable treatment for any transaction in the VAT system. Vendors making zero rated supplies are usually owed refunds by SARS. There is no conceivable reason why, where PBO's engage in commercial activities they should be treated differently from other commercial entities.
>
> [35] It is clear from the above discussion that payment received by a designated entity such as the Trust in this case, from a public authority such as a provincial health department, for actual supply of services taxable under section 7(1)(*a*) of the VAT Act, fall outside the scope of section 8(5). Therefore the deeming provision is not applicable to them and they do not qualify for zero-rating under section 11(2)(*n*). To hold otherwise would be to do violence to the fundamental architecture of the VAT Act, create uncertainty and impact negatively on the fiscus and its ability to assist the government in service delivery."

(Footnote suppressed.)

For more information on the general VAT treatment of welfare organisations, see Interpretation Note 70 "Supplies Made for no Consideration" and *VAT 414 – Guide for Associations not for Gain and Welfare Organisations*.

### 4.11.4 Zero-rated SETA training grants paid to designated entities [section 11(2)(*u*)]

*The services are deemed to be supplied in terms of section 8(5) by a designated entity in respect of any payment made in terms of section 10(1)(f) of the Skills Development Act, 1998 (Act No. 97 of 1998), to that designated entity*

The 2005 amendments had the unintended effect that all grants payable to designated entities will generally be subject to VAT at the standard rate (subject to certain exceptions as discussed in **4.3**, **4.9** and **4.11.3**). As a result, SETA training grants paid to designated entities could not qualify for zero-rating as is the case for other vendors. As designated entities are also liable for SDL payments and are also entitled to receive training grants under section 10(1)(*f*) of the Skills Development Act 97 of 1998, to avoid an unfair result, the VAT Act was amended with retrospective effect to 1 April 2005 to ensure that SETA training grants paid to designated entities are zero-rated.

### 4.11.5 Zero-rated supplies of controlled animals or things under section 19 of the Animal Diseases Act, 1984 [section 11(1)(*r*)]

*Compensation is paid by a public authority in terms of section 19 of the Animal Diseases Act, 1984 (Act No. 35 of 1984) for the supply of a "controlled animal or thing" as defined in that Act to that public authority*

Another issue related to the 2005 amendments is that compensation paid by a public authority to a vendor (usually a farmer) to supply a "controlled animal or thing" as contemplated under section 19 of the Animal Diseases Act 35 of 1984 was not included in the zero-rating under section 11(2)(*t*). The reason is that the vendor in such cases is required to supply the actual diseased animals concerned to the public authority making the payment. The compensation paid to the farmer therefore constitutes consideration for an actual taxable supply of goods and cannot give rise to a deemed taxable supply of services under section 8(5A). (See the discussion in **4.11.3** in this regard.)

The VAT Act was subsequently amended with effect from 7 February 2007 to provide for such payments to be subject to the zero rate under section 11(1)(*r*). The zero-rating under section 11(2)(*r*) can only apply when payment for the "controlled animal or thing" is made by a "**public authority**" (as defined).

### 4.12 Change in use adjustments (denial of input tax) [section 18(4)]

Section 18(4) provides for input tax to be deducted in certain instances where there has been a change in the use or application of goods or services which were originally acquired for exempt, private, or other non-taxable purposes and subsequently applied wholly or partially for taxable use or application. This will apply, for example, when VAT was paid on the acquisition of dwellings used to generate exempt rental income, and the dwellings are subsequently converted into offices or commercial accommodation and rented out as such.

Since the classification of public entities in terms of the PFMA is used as a basis for determining how an entity is treated for VAT purposes, any re-classification of that entity within those Schedules may have a VAT implication. Where an entity is not registered for VAT, as it is classified as a "public authority" or a "constitutional institution", the re-classification of that entity (or a part of its activities) may result in that entity becoming liable to register. If this occurs, proviso (iv) to section 18(4) will prevent that entity from deducting any input tax on the adjustment which would otherwise have been allowed for any assets brought into the "enterprise" in respect of which it is now required to register.

**Example 8 – Denial of input tax adjustment upon reclassification**

If an entity in Schedule 3C of the PFMA (provincial public entity) is re-classified under Schedule 3D of the PFMA (provincial government business enterprise), it will not be able to make an input tax adjustment on its existing assets which are now applied for taxable purposes as a result of the re-classification.

The terms “re-classified” and “applies” in the context of proviso (iv) to section 18(4), refer to the extent of the change in the taxable status of the entity’s activities as a result of the re-classification in terms of the PFMA (and hence the change in application of certain assets for that purpose). This re-classification may have required the entity to be notified to register to the extent that the supplies are regarded as taxable under paragraph (*b*)(i) of the definition of “enterprise”. Whether wholly or partially taxable, an input tax adjustment is denied to the extent that the assets are subsequently applied for enterprise purposes as a result of the re-classification.

**Example 9 – Denial of input tax adjustment upon transfer of non-enterprise assets to a taxable entity or separate taxable trading account**

- When a Schedule 3A PFMA entity (public authority) transfers assets used for out-of-scope “public authority” activities into a separate “ring-fenced” trading account in order to carry on a taxable business activity in respect of which it has been (or will be) notified to register for VAT under paragraph (*b*)(i) of the definition of “enterprise”.
- When a Schedule 3C PFMA entity (public authority) provides funds and/or assets for the purposes of conducting a business activity under a separate legal entity formed (or to be formed) for that purpose. For example, when the entity transfers existing funds or assets originally received for exempt or out-of-scope “public authority” activities to a Schedule 3D PFMA entity (vendor and “designated entity”), which it controls, for the purposes of making taxable supplies.

### 4.13 Registration of persons making supplies in the course of enterprises where the public entity should have registered before 1 April 2005 [proviso to section 23(4)]

Section 23(4) provides that where any person has applied for registration within the required 21-day period after becoming liable, or otherwise qualifies for voluntary registration, the Commissioner may determine the date that the person shall be a vendor for VAT purposes. A person that is required to register for VAT and did not apply within the prescribed 21-day period is regarded as a vendor from the date that the person first became liable to register. However, having regard to what is considered equitable in the circumstances of the case, the Commissioner may determine a later liability date for that person.

As from 1 April 2005 all public entities listed in Schedule 1 and most of the entities listed in Part A or C of Schedule 3 to the PFMA, which were registered as vendors before that date were required to deregister. Only in very limited circumstances were these entities required to register as vendors or remain on the VAT register if they had already registered. Under the proviso to section 23(4), the Commissioner may not register such public entity in respect of any enterprise activities carried on before 1 April 2005.

## 5. Practical implications

### 5.1 New registrations

Certain public authorities were notified by SARS that they should be registered for all or some of their activities under paragraph (*b*)(i) of the definition of "enterprise", after receiving the decision of the Minister in this regard. In addition, if a public authority is not notified as stated above, it may make an application to register**. Such an application must be considered by the Commissioner and the Minister, so it will not follow the normal registration procedure which applies for other vendors.**

The details of the case and the public authority's reasons for wanting to register must be clearly motivated in a written application headed "Application for a VAT Ruling" and sent by email to **VATRulings@sars.gov.za** or facsimile on +27 86 540 9390.

After considering the merits of the case in consultation with National Treasury and the chief executive and chief financial officer of the public authority, that entity will be notified whether or not it may register for VAT. Only once SARS and National Treasury are in agreement with the circumstances under which registration is sought by the public authority, will the matter be forwarded to the Minister to consider the decision to notify the entity to register.

### 5.2 Budgeting

Public authorities that are notified to register for VAT on or after 1 April 2005 in respect of any enterprise activities carried on must prepare their budgets and calculate their costs of doing business accordingly. This must be done on the basis that the VAT incurred on capital and operational expenses associated with the enterprise activities will not be an accounting "cost". The reason is that input may be deducted to the extent that an enterprise is conducted. To the extent that the public authority has activities in respect of which it has not been notified, the VAT incurred will be included in the accounting cost for financial reporting purposes.

On the income side of the budget, the setting of prices, levies etc must be revised to take account of the fact that any amounts charged or levied in connection with taxable activities in respect of which it has been notified, will include VAT from the date of notification. Further, that when any government grant is paid to the notified public authority (which will, as a result, be a "designated entity") the deemed supply which arises under section 8(5) will be subject to VAT at the standard rate. No deemed supply arises if the payment relates to non-taxable activities or constitutes consideration for an actual taxable supply under section 7(1)(*a*) as discussed in **4.11.3**.

### 5.3 Procurement of goods and services vs "unrequited" grant payments

Public authorities, municipalities and constitutional institutions must ensure that they understand the difference in the tax treatment between a deemed supply which arises in respect of the receipt of grant (zero percent VAT in the hands of the recipient), and the payment of consideration for a taxable supply (standard-rated VAT payable by the supplier to the recipient). (See the discussion in **4.11.3** for further information.)

Vendors that receive payments from departments, public entities or municipalities should ensure that they are informed quite clearly in terms of their contract or other payment advice, whether the amount constitutes a "grant" (gratuitous or "unrequited"

payment), or if it is consideration paid in respect of a taxable supply of goods or services to that entity for own consumption, or for supply to a third person. By having a clear understanding of the nature of the payment received, the correct tax treatment can be determined and applied. This will avoid the situation where a vendor finds it necessary to seek clarity from SARS on the correct VAT treatment of the payment after the fact. Alternatively, clarifying the VAT treatment upfront will prevent a situation where an increase in the amount concerned needs to be renegotiated as a result of any incorrect assumptions made when calculating the budgeted amount.

### 5.4 "Ring-fencing" of trading activities

Public authorities, as a general rule, are not able to register for VAT unless they are notified as required in paragraph (*b*)(i) of the definition of "enterprise". Any decision to register a public authority that comes forward to request that their trading activities should be regarded as taxable is determined as set out in **5.1**.

In order for a public authority to qualify as an "enterprise", the activity which is sought to be treated as taxable must be "ring-fenced" and moved out of mainstream non-enterprise activities of that department or Schedule 3A or 3C PFMA entity, and conducted under a separate subsidiary legal entity (unless all of the activities conducted by that public authority are regarded as taxable). Alternatively, the taxable activity must be "ring-fenced" and conducted under a separate trading account, branch or division of that public authority. The separate entity or taxable trading account, branch or division must then be notified to register or apply for registration as mentioned in **5.1**.

Any transfer of funds or assets from the main public authority (non-vendor) to its taxable trading account or deemed Schedule 3B or 3D "designated entity" (vendor) will have the following VAT implications:

(a) *Transfer of funds* – Output tax must be declared by the recipient as the amount constitutes consideration for a deemed taxable supply [section 8(5)]. When the taxable trading account or deemed designated entity incurs VAT inclusive expenses, it is allowed to deduct input tax thereon to the extent that it makes taxable supplies if it meets all the other requirements for deducting input tax (for example, sections 16(2), 16(3), 17(1), 20, etc).

(b) *Transfer of existing assets and other goods and services held before 1 April 2005* – No input tax adjustment is allowed to the separate taxable trading account or deemed designated entity when it receives those goods or services for taxable application in the enterprise. (Section 18(4) proviso (iv).)

(c) *Purchase and transfer of goods or services acquired on or after 1 April 2005* – If the main public authority acquires goods or services on or after 1 April 2005 on its budget (as principal) and these are subsequently transferred to its separate taxable trading account or deemed designated entity, neither the main public authority (non-vendor), nor the recipient is able to deduct input tax thereon (Section 18(4) proviso (iv).)

(d) *Subsequent sale of goods or services where input tax was denied in terms of Section 18(4) proviso (iv)* – When goods or services were acquired as discussed in (ii) and (iii) above, and those things are subsequently supplied in the course of an enterprise by that separate taxable trading account or deemed designated entity, output tax must be charged at the standard rate.

No input tax is allowed under section 16(3)(*h*) in respect of that subsequent supply.

## 5.5 Classification of new entities and re-classification of existing entities in terms of the PFMA

The VAT treatment of new public entities which are in the process of being classified and existing public entities which are re-classified in terms of the PFMA on or after 1 April 2005 must be decided upon by National Treasury in consultation with SARS. Any decision in this regard will be based upon the policy principles discussed in this document as well as the circumstances of the particular case and similar cases encountered.

The possible VAT consequences of the transfer of funds or assets from public authorities to newly created entities or to separate trading accounts are set out in **5.4**.

## 5.6 Foreign donor funded projects

As a general rule, a "public authority" is not liable or entitled to register for VAT unless it is notified to that effect as contemplated in **5.1** above. However, some public authorities are involved in implementing projects for the general upliftment of South Africa and its citizens. These projects are funded in terms of international agreements between the South African government and foreign governments, or other international development agencies such as the European Union, the United Nations, the World Bank, United States Agency of International Development (USAID), Department for International Development (DfID) etc.

The person administering such an arrangement may voluntarily register the project for VAT if the arrangement meets all the requirements of a "foreign donor funded project" (FDFP) as defined in section 1(1). The requirements for VAT registration include that the project must be established as a result of an international donor funding agreement which involves the supply of goods or services to beneficiaries and the South African government must be a party to that agreement. These international agreements are referred to as Official Development Agreements (ODAs) and are binding on the Republic under section 231(3) of the Constitution of the Republic of South Africa, Act 108 of 1996. The ODAs normally provide that the funds donated should only be used for specific, mutually agreed upon programmes and activities, and cannot be used to pay for any taxes imposed under South African Law.

The purpose of allowing FDFPs to register voluntarily is to enable the refund of any VAT incurred for the purposes of a project. In so doing, the requirements of the ODA will be met, in that the donated funds will be free from tax. The ability to deduct input tax in the case of an FDFP also extends to include the VAT incurred on motor cars and entertainment which are usually denied to other vendors. However, the input tax deductions are limited to the VAT incurred on goods or services acquired which are directly in connection with the implementation of the FDFP. For example, if the FDFP is administered by a public authority, that public authority is not entitled to deduct input tax on its normal VAT-inclusive capital and operating costs.

Any registration of an FDFP should not be confused with a liability to register for normal taxable supplies, as FDFPs are allowed to register voluntarily under a special dispensation. FDFPs that are administered by public authorities are therefore not required to be notified to register under paragraph (*b*)(i) of the definition of "enterprise" as discussed in **5.1**.

When a public authority has been permitted to register for VAT in respect of an FDFP that it administers, the words "(international donor funded project)" must follow the trading name on the registration application form so that the VAT file and registration particulars on the system can be noted accordingly.

The VAT treatment of FDFPs can be summarised briefly as follows:

(a) The FDFP is allowed to register for VAT on the basis that it is deemed to supply services to the foreign donor to the extent of the donor funding received to carry out the project.

(b) The deemed services of the FDFP in (a) above are subject to VAT at the zero rate [see sections 8(5B) and 11(2)(*q*)].

(c) VAT must still be charged, where applicable, by suppliers of goods and/or services actually acquired by the FDFP using donated funds in carrying out the project deliverables.

(d) The FDFP will deduct input tax to the extent that the expenses in (c) above relate to the project, provided that the relevant tax invoices are held.

(e) The FDFP will only be allowed to deduct the VAT that it incurs. The arrangement does not extend so far as to include the VAT incurred by the service providers to the FDFP mentioned in (c) above.

## 6. Conclusion

The VAT treatment of public authorities and grants can be summarised as follows with effect from 1 April 2005:

- The definition of "public authority" was amended to include all the government departments listed in Schedules 1, 2 and 3 of the PSA, as well as the public entities listed in Schedules 3A and 3C of the PFMA. The definition excludes constitutional institutions and business orientated public entities (listed in Schedules 1, 2, 3B and 3D of the PFMA).

- PFMA entities listed in Schedules 1, 3A and 3C which registered for VAT before 1 April 2005, were required to deregister for VAT (unless they were notified as required under paragraph (*b*)(i) of the definition of "enterprise"). Relief from the output tax which would otherwise have been payable upon deregistration under section 8(2) was provided to these entities. (Proviso (iv) to section 8(2).)

- SARS may not retrospectively register any public entity listed in Schedules 1, 3A and 3C of the PFMA which failed to register before 1 April 2005. Such entities were therefore not liable to account for any output tax, nor could they claim any refund in respect of any period before 1 April 2005. (Proviso to section 23(4).)

- Section 40A was introduced to provide a relief mechanism for a public authority or public entity listed in Schedules 1, 3A or 3C of the PFMA that was registered for VAT before 1 April 2005, but incorrectly treated a payment as a zero-rated "transfer payment" before that date if it was assessed for that liability. SARS was also prevented from raising an assessment in respect of those incorrectly treated payments. Section 40A was subsequently deleted as the issues addressed in the provision have prescribed.

- The definition of “transfer payment” as well as section 11(2)(*p*) that zero-rated the receipt of those payments were both deleted. The definition of “transfer payment” was replaced with the definition of “grant” to provide more certainty as to which payments (appropriations or subsidies) from government qualify for zero-rated tax treatment.
- Grants to vendors (other than designated entities) are zero-rated under sections 8(5A) and 11(2)(*t*). This includes a gratuitous payment by a municipality to a private vendor (other than a designated entity, which is not a welfare organisation) provided the payment is truly gratuitous as contemplated in section 67 of the MFMA and has not been incorrectly classified as such. Examples of designated entities are business entities listed in Schedules 2, 3B and 3D of the PFMA, entities listed in Schedules 3A and 3C of the PFMA that have been notified to register by the Commissioner, and municipal entities.
- Payments made by the Department of Human Settlements to vendors (including municipalities) under a national housing programme do not qualify as zero-rated grants. The potential zero-rating of such payments must be considered under sections 8(23) and 11(2)(*s*).
- An appropriation in terms of the DOR Act such as a “municipal infrastructure grant” or “equitable share” also qualifies as a zero-rated “grant”, unless the recipient is a “designated entity” (not being a welfare organisation).
- A “grant” excludes procurement and other methods of acquiring goods and services by constitutional institutions, public authorities and municipalities (that is, the payment must not constitute consideration paid in respect of the actual supply of goods or services under section 7(1)(*a*) to the entity making the payment, or for a specific taxable supply by the recipient to a third party).
- Section 8(5) was amended so that it now only applies to a “designated entity”. Payments made to designated entities, which are for enterprise purposes, generally attract VAT at the standard rate.
- Designated entities may only zero rate payments from constitutional institutions, public authorities or municipalities when –
    - the amount is a grant for training employees (SETA grants received), or
    - the recipient is a “welfare organisation” and the funds are for the purposes of carrying out “welfare activities” for the benefit of persons other than the person making the payment.

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## Annexure A – Wording of certain provisions in the VAT Act

## PART 1 – Wording before 1 April 2005

### Section 1 - Definitions

### Enterprise [Paragraphs (*b*)(i) and (*c*)]

**''Enterprise"** means—

(*a*) in the case of any vendor other than a local authority, …

(*b*) without limiting the applicability of paragraph (a) in respect of any activity carried on in the form of a commercial, financial, industrial, mining, farming, fishing or professional concern—

(i) the making of supplies by any public authority of goods or services which the Minister, having regard to the circumstances of the case, is satisfied are of the same kind or are similar to taxable supplies of goods or services which are or might be made by any person other than such public authority in the course or furtherance of any enterprise, if the Commissioner, in pursuance of a decision of the Minister under this subparagraph, has notified such public authority that its supplies of such goods or services are to be treated as supplies made in the course or furtherance of an enterprise;

(ii) …

(iii) …

(*c*) in the case of a vendor which is a local authority, any activity in the course or furtherance of which any of the following supplies of goods or services are made:

(i) The supply of electricity, gas or water;

(ii) the supply of services consisting of the drainage, removal or disposal of sewage or garbage;

(iii) the supply of goods or services incidental to or necessary for … subparagraph (i) or (ii) apply;

(iv) the making of supplies of goods or services in the course of any business carried on by such local authority, if—

(*aa*) such supplies are of the same kind or are similar … made by any person other than such local authority …; and

(*bb*) the revenue normally derived …, together with any grant or subsidy …, sufficient to fund the expenditure … incurred by that local authority in the production of such revenue; and

(*cc*) (A) such business falls within a category of businesses which the Minister, having regard to the provisions of items (aa) and (bb) as generally applicable, has by notice in the Gazette determined to be a category of businesses in respect of which the provisions of this subparagraph shall be deemed to apply; or

(B) such business (not being a business falling within a category referred to in subitem (A)) is determined by the Minister, having regard to the provisions of items (aa) and (bb) as applicable in the case of such business, to be a business in respect of which the provisions of this subparagraph shall be deemed to apply and the Commissioner, in pursuance of the Minister's determination under this subitem, has notified such local authority accordingly,

and, in the case of a regional services council, a joint services board or a transitional metropolitan council, any other activities of that council or board to the extent that they are financed by levies referred to in section 8(6)(b).

**Note:** Paragraph (*c*) of the definition of "enterprise" was subsequently deleted with effect from 1 July 2006.

**Local authority**

**''Local authority"** means—

(*a*) any divisional council, rural council, municipal council, regional services council, town board, local board, village management board or health committee or any joint services board established under the KwaZulu and Natal Joint Services Act, 1990 (Act No. 84 of 1990);

(*b*) any other body, council, board, committee or institution established or deemed to be established by or under any law which has functions similar to those of the councils, boards and committees enumerated in paragraph (a) and which may levy rates on the value of immovable property within its area of jurisdiction or receive payments for services rendered or to be rendered; and

(*c*) any water board or regional water services corporation or any other institution which has powers similar to those of any such boards or corporations:

Provided that where any local authority has been disestablished and superseded by a new local authority in terms of the Local Government: Municipal Structures Act,1998 (Act No. 117 of 1998), such disestablished local authority and such new local authority shall for the purposes of this Act be deemed to be and to have been one and the same local authority.

**Note:** The definition was subsequently deleted and replaced with the definition of a "municipality" with effect from 1 July 2006.

**Public authority**

**''Public authority"** means any department or division of the public service (including a provincial administration, the South African National Defence Force, the South African Police Service and Correctional Services).

**Note:** The definition was amended on 1 April 2005 to be more specific by including reference to the departments listed in the PSA and certain public entities listed in the PFMA.

**Services**

**''Services"** means 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, but excluding a supply of goods, money or any stamp, form or card contemplated in paragraph (c) of the definition of "goods".

**Transfer payment**

**"Transfer payment"** means a transfer payment as contemplated in regulation 8.4 of the Treasury Regulations published in terms of the Public Finance Management Act, 1999 (Act No. 1 of 1999).

**Note:** The definition was deleted on 1 April 2005 together with the zero-rating for transfer payments under section 11(2)(*p*).

**Section 8 – Certain supplies of goods or services deemed to be made or not made**

**Section 8(5)**

(5) For the purposes of this Act a vendor shall be deemed to supply services to any public authority or local authority to the extent of any payment made by the authority concerned to or on behalf of the vendor in respect of the taxable supply of goods or services by the vendor to any person.

**Note:** The definition was amended on 1 April 2005 so that it would only apply to designated entities on or after that date.

**Section 11(2) – Zero-rating of services**

**Section 11(2)(*p*)**

(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, subject to compliance with subsection (3) of this section, be charged with tax at the rate of zero per cent where—

…

(*p*) the services are in terms of section 8(5) deemed to be supplied to a public authority to the extent that the payment contemplated in that section consists of a transfer payment; or

…

**Note:** This provision was deleted on 1 April 2005 together with the definition of "transfer payment" to which it related.

**PART 2 – Wording on or after 1 April 2005**
**Section 1(1) – Definitions**

**Enterprise**

**Paragraph (*b*)(i)**

**''Enterprise"** means—

(*a*)…

(*b*) without limiting the applicability of paragraph (a) in respect of any activity carried on in the form of a commercial, financial, industrial, mining, farming, fishing or professional concern—

(i) the making of supplies by any public authority of goods or services which the Minister, having regard to the circumstances of the case, is satisfied are of the same kind or are similar to taxable supplies of goods or services which are or might be made by any person other than such public authority in the course or furtherance of any enterprise, if the Commissioner, in pursuance of a decision of the Minister under this subparagraph, has notified such public authority that its supplies of such goods or services are to be treated as supplies made in the course or furtherance of an enterprise.

**Proviso (viii)**

The definition of "enterprise" was amended by the insertion of proviso (viii) to exclude a constitutional institution.

Provided that—

…

(vii) the making of supplies by a constitutional institution listed in Schedule 1 of the Public Finance Management Act, 1999 (Act 1 of 1999), shall be deemed not to be the carrying on of an enterprise.

**Designated entity**

The definition of a "designated entity" was inserted to provide for all entities in which government has an interest which carry on enterprises, and to provide for welfare organisations.

**"Designated entity"** means a vendor—

(i) to the extent that its supplies of goods and services of an activity carried on by that vendor are in terms of (b)(i) of the definition of 'enterprise' treated as supplies made in the course or furtherance of an enterprise;

(ii) which is a major public entity, national government business enterprise or provincial government business enterprise listed in Schedule 2 or Part B or D of Schedule 3 of the Public Finance Management Act, 1999 (Act No.1 of 1999), respectively; or

(iii) which is a party to a 'Public Private Partnership Agreement' as defined in Regulation 16 of the Treasury Regulations issued in terms of section 76 of the Public Finance Management Act, 1999 (Act No. 1 of 1999): or;

(iv) which is a welfare organisation; or

(v) which is a municipal entity as defined in section 1 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000);or

(vi) which has powers similar to those of any water board listed in Part B of Schedule 3 of the Public Finance Management Act, 1999 (Act No. 1 of 1999), which would have complied with the definition of 'local authority' in section 1 prior to the deletion of that definition on 1 July 2006;

**Grant**

The definition of a "grant" was inserted to provide a greater degree of certainty in identifying the type of payments which are intended to qualify for zero-rated tax treatment.

**"grant"** means any appropriation, grant in aid, subsidy or contribution transferred, granted or paid to a vendor by a public authority, [local authority] municipality or constitutional institution listed in Schedule 1 to the Public Finance Management Act, 1999 (Act No. 1 of 1999), but does not include—

(*a*) a payment made for the supply of any goods or services to that public authority or [local authority] municipality, including all goods or services supplied to a public authority, [local authority] municipality or constitutional institution listed in Schedule 1 to the Public Finance Management Act, 1999 (Act No. 1 of 1999) in accordance with a procurement process prescribed—

(i) in terms of the Regulations issued under section 76(4)(c) of the Public Finance Management Act, 1999 (Act No. 1 of 1999); or

(ii) in terms of Chapter 11 of the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003), or any other similar process; or

(*b*) a payment contemplated in section 8(23).

In terms of section 128(1)(*g*) of the Taxation Laws Amendment Act 25 of 2015 paragraph (*b*) of the definition was amended with effect from 1 April 2017 to exclude any payment under a national housing programme contemplated in the Housing Act 107 of 1997. Note, however, that in the Minister's Budget in February 2017, it was proposed that the deletion of provisions in connection with any payments by the Department of Human Settlements under a national housing programme would be delayed until 1 April 2019.

**Public authority**

The definition of "public authority" was amended to be more specific by including reference to the departments listed in the PSA and certain public entities listed in the PFMA.

**''public authority"** means**—**

(i) any department or division of the public service as listed in Schedules 1, 2 or 3 of the Public Service Act, 1994 (Act No. 103 of 1994); or

(ii) any public entity listed in Part A or C of Schedule 3 to the Public Finance Management Act, 1999 (Act No. 1 of 1999); or

(iii) any other public entity designated by the Minister for the purposes of this Act to be a public authority.

**Transfer payment**

Definition deleted.

**Other definitions**

The definition of the term "services" remained unchanged, as did "local authority", until it was deleted and replaced with the term "municipality" on 1 July 2006. A textual amendment in the definition of the term "consideration" replaced the term "unconditional gift" with the term "donation".

**Section 8 – Certain supplies of goods or services deemed to be made or not made**

**Section 8(2) proviso (iv)**

Proviso (iv) was inserted to provide relief in respect of the VAT that would arise upon deregistration of entities which fall within the definition of a "public authority" on or after 1 April 2005.

(iv) this subsection shall not apply to a vendor that is a constitutional institution listed in Schedule 1 to the Public Finance Management Act, 1999 (Act No. 1 of 1999) or a public authority, respectively, where that vendor (other than a vendor who applied and was registered as a vendor during the period 22 December 2003 to 31 March 2005) ceases to be a vendor as a result of—

(*aa*) the substitution of the definition of 'public authority' in the Revenue Laws Amendment Act, 2004 or the insertion of paragraph (viii) to the proviso to the definition of 'enterprise' in the Revenue Laws Amendment Act, (Act No. 45 of 2003); or

(*bb*) the re-classification of that vendor or part of that vendor's activities within the Schedules to the Public Finance Management Act, 1999 (Act No. 1 of 1999) subsequent to the introduction of the Revenue Laws Amendment Act, 2004.

**Section 8(5)**

Section 8(5) was amended so that it only applies to a "designated entity" on or after 1 April 2005. Note that the wording below is the current wording as subsequently amended in terms of Revenue Laws Amendment Act 20 of 2006.

(5) For the purposes of this Act a designated entity shall be deemed to supply services to any public authority or municipality to the extent of any payment made by the public authority or municipality concerned to or on behalf of that designated entity in the course or furtherance of an enterprise carried on by that designated entity.'

**Section 8(5A)**

Section 8(5A) was inserted with effect from 1 April 2005 as a result of the amendment to section 8(5) to deal with grants paid to vendors that are not designated entities. The wording below is the current wording as subsequently amended in terms of the Revenue Laws Amendment Act 20 of 2006.

(5A) For the purposes of section 11(2)(t), a vendor (excluding a designated entity) shall be deemed to supply services to any public authority, municipality or constitutional institution listed in Schedule 1 to the Public Finance Management Act, 1999 (Act No. 1 of 1999) to the extent of any grant paid to or on behalf of that vendor in the course or furtherance of an enterprise carried on by that vendor.'

**Section 11(2) – Zero-rating of services**

**Section 11(2)(*p*)**

The provision relating to transfer payments was deleted.

**Section 11(2)(*t*)**

This provision was inserted with effect from 1 April 2005 to provide a zero-rating of the deemed supply which arises in respect of the receipt of a "grant".

(*t*) the services are deemed to be supplied in terms of section 8(5A).

**Section 11(2)(*n*)**

A textual amendment was made to this provision as a result of a "welfare organisation" being included in the definition of a "designated entity" with effect from 1 April 2005.

(*n*) the services comprise the carrying on by a welfare organization of the activities referred to in the definition of 'welfare organization' in section 1 and to the extent that any payment in respect of those services is made in terms of section 8(5) those services shall be deemed to be supplied by that organisation to a public authority or municipality.

**Section 11(2)(*u*)**

This provision was inserted to provide a zero-rating in respect of the receipt of training grant by a designated entity under the Skills Development Act, 1998.

> (*u*) the services are deemed to be supplied in terms of section 8(5) by a designated entity in respect of any payment made in terms of section 10(1)(f) of the Skills Development Act, 1998 (Act No. 97 of 1998), to that designated entity.

**Section 18(4) – Change in use adjustments**

**Proviso (iv) to section 18(4)**

Proviso (iv) was inserted to deny an input tax adjustment relating to assets acquired by non-taxable public authorities and certain public entities before 1 April 2005 which were applied for enterprise purposes after that date if that entity is re-classified in terms of the PFMA as a taxable entity.

> (iv) this subsection shall not apply where a constitutional institution listed in Schedule 1 or a public entity listed in Part A or C of Schedule 3 to the Public Finance Management Act, 1999 (Act No. 1 of 1999), is re-classified within the Schedules to the Public Finance Management Act, 1999 (Act No. 1 of 1999) and applies those goods or services for the purposes of consumption, use or supply in the course of making taxable supplies.

**Section 23(4) – Registration of persons making supplies in the course of enterprises**

**Proviso to section 23(4)**

A proviso was inserted to provide that certain public entities would not be liable for VAT on transactions before 1 April 2005 if they were liable to register before that, but did not do so.

> (4) Where any person has—
>
> (a) applied for registration … subsection (2) or (3) …, that person shall be a vendor …with effect from such date as the Commissioner may determine;
>
> (b) not applied for registration in terms of subsection (2) and the Commissioner is satisfied that that person is liable to be registered …, that person shall be a vendor … with effect from the date on which that person first became liable to be registered in terms of this Act: Provided that the Commissioner may, having regard to the circumstances of the case, determine that person to be a vendor from such later date as the Commissioner may consider equitable.
>
> Provided that where that person is a public entity listed in Schedule 1 or Part A or C of Schedule 3 to the Public Finance Management Act, 1999 (Act No. 1 of 1999), which was liable to be registered as a vendor for any supplies made on or before 31 March 2005, but did not register before 1 April 2005, the Commissioner must not register that person in respect of those supplies.

**Section 40A – Liability of public authorities and certain public entities for tax and limitation of refunds**

This provision was inserted to provide relief in regard to the incorrect treatment of transfer payments before 1 April 2005.

(1) This section applies in respect of the supply of goods or services on or before 31 March 2005 by any public authority or public entity listed in Schedule 1 or Part A or C of Schedule 3 to the Public Finance Management Act, 1999 (Act No. 1 of 1999).

(2) Where the Commissioner on or before 31 March 2005 issued an assessment for an amount of tax or additional tax in respect of any supply of goods or services contemplated in subsection (1), to correct a prior incorrect application of the zero per cent rate of tax in terms of section 11(2)(p) in respect of that supply, the Commissioner must, on written application, reduce that assessment to the extent that the amount of tax, additional tax penalty or interest arose as a result of that correction and was not yet paid on that date: Provided that the reduced assessment will not result in a refund to that public authority or public entity.

(3) The Commissioner may not after 31 March 2005 make any assessment to correct a prior incorrect application of the zero per cent rate of tax in terms of section 11(2)(p) in respect of any supply of goods or services contemplated in subsection (1).

(4) If a public authority or public entity incorrectly charged tax at the rate referred to in section 7(1) instead of the zero per cent rate of tax in terms of section 11(2)(p) in respect of any supply contemplated in subsection (1), the Commissioner may not refund any such tax or any penalty or interest that arose as a result of the late payment of such tax, paid by that public authority or public entity to the Commissioner.”.

Section 40A was subsequently deleted in terms of section 100 of the Taxation Laws Amendment Act 43 of 2014 with effect from 20 January 2015 as the content of the provision had prescribed.

**Annexure B – Public Service Act, 1994 (PSA) – National and provincial departments and their components**

## SCHEDULE 1

## NATIONAL DEPARTMENTS AND OFFICES OF PREMIER AND HEADS THEREOF

| *Column 1*<br>*NATIONAL DEPARTMENTS* | *Column 2*<br>*HEADS OF NATIONAL DEPARTMENTS* |
|---|---|
| Civilian Secretariat for the Police Service | Secretary: Civilian Secretariat for the Police Service |
| Department of Agriculture, Forestry and Fisheries | Director-General: Agriculture, Forestry and Fisheries |
| Department of Arts and Culture | Director-General: Arts and Culture |
| Department of Basic Education | Director-General: Basic Education |
| Department of Communications | Director-General: Communications |
| Department of Cooperative Governance | Director-General: Cooperative Governance |
| Department of Correctional Services | Commissioner: Correctional Services |
| Department of Defence | Secretary for Defence |
| Department of Energy | Director-General: Energy |
| Department of Environmental Affairs | Director-General: Environmental Affairs |
| Department of Health | Director-General: Health |
| Department of Higher Education and Training | Director-General: Higher Education and Training |
| Department of Home Affairs | Director-General: Home Affairs |
| Department of Human Settlements | Director-General: Human Settlements |
| Department of International Relations and Cooperation | Director-General: International Relations and Cooperation |
| Department of Justice and Constitutional Development | Director-General: Justice and Constitutional Development |
| Department of Labour | Director-General: Labour |
| Department of Military Veterans | Director-General: Military Veterans |
| Department of Mineral Resources | Director-General: Mineral Resources |
| Department of Performance Monitoring and Evaluation | Director-General: Performance Monitoring and Evaluation |
| Department of Planning, Monitoring and Evaluation | Director-General Planning, Monitoring and Evaluation |
| Department of Police | National Commissioner: South African Police Service |
| Department of Public Enterprises | Director-General: Public Enterprises |
| Department of Public Service and Administration | Director-General: Public Service and Administration |
| Department of Public Works | Director-General: Public Works |
| Department of Rural Development and Land Reform | Director-General: Rural Development and Land Reform |
| Department of Science and Technology | Director-General: Science and Technology |
| Department of Small Business Development | Director-General: Small Business Development |
| Department of Social Development | Director-General: Social Development |
| Department of Telecommunications and Postal Services | Director-General: Telecommunications and Postal Services |
| Department of Tourism | Director-General: Tourism |
| Department of Trade and Industry | Director-General: Trade and Industry |

| ***Column 1***<br>***NATIONAL DEPARTMENTS*** | ***Column 2***<br>***HEADS OF NATIONAL DEPARTMENTS*** |
|---|---|
| Department of Traditional Affairs | Director-General: Traditional Affairs |
| Department of Transport | Director-General: Transport |
| Department of Water Affairs | Director-General: Water Affairs |
| Department of Water Affairs and Sanitation | Director-General: Water Affairs and Sanitation |
| Department of Women, Children and People with Disabilities | Director-General: Women, Children and People with Disabilities |
| Department of Women | Director-General: Women |
| Economic Development Department | Director-General: Economic Development |
| Government Communication and Information System | Director-General: Government Communication and Information System |
| Independent Police Investigative Directorate | Executive Director: Independent Police Investigative Directorate |
| National School of Government | Principal: National School of Government |
| National Treasury | Director-General: National Treasury |
| Office of the Chief Justice | Secretary-General: Office of the Chief Justice |
| Office of the Public Service Commission | Director-General: Office of the Public Service Commission |
| Sport and Recreation | Director-General: Sport and Recreation |
| State Security Agency | Director-General: State Security Agency |
| Statistics South Africa | Statistician-General: Statistics South Africa |
| The Presidency | Director-General: The Presidency |
| ***Column 1***<br>***OFFICES OF PREMIER*** | ***Column 1***<br>***HEADS OF OFFICES OF PREMIER*** |
| Office of the Premier: Eastern Cape | Director-General: Office of the Premier of Eastern Cape |
| Office of the Premier: Free State | Director-General: Office of the Premier of Free Sate |
| Office of the Premier: Gauteng | Director-General: Office of the Premier of Gauteng |
| Office of the Premier: KwaZulu-Natal | Director-General: Office of the Premier of KwaZulu-Natal |
| Office of the Premier: Limpopo | Director-General: Office of the Premier of Limpopo |
| Office of the Premier: Mpumalanga | Director-General: Office of the Premier of Mpumalanga |
| Office of the Premier: Northern Cape | Director-General: Office of the Premier of Northern Cape |
| Office of the Premier: North West | Director-General: Office of the Premier of North West |
| Office of the Premier: Western Cape | Director-General: Office of the Premier of Western Cape |

## SCHEDULE 2

## PROVINCIAL DEPARTMENTS AND HEADS THEREOF

***(Section 7(2) and (3))***

| ***Column 1***<br>***PROVINCIAL DEPARTMENTS*** | ***Column 2***<br>***HEADS OF PROVINCIAL DEPARTMENTS*** |
|---|---|
| **Eastern Cape** | |
| Department of Cooperative Governance and Traditional Affairs | Head: Cooperative Governance and Traditional Affairs |
| Department of Economic Development, Environmental Affairs and Tourism | Head: Economic Development, Environmental Affairs and Tourism |
| Department of Education | Head: Education |
| Department of Health | Head: Health |
| Department of Human Settlements | Head: Human Settlements |
| Department of Roads and Public Works | Head: Roads and Public Works |
| Department of Rural Development and Agrarian Reform | Head: Rural Development and Agrarian Reform |
| Department of Safety and Liaison | Head: Safety and Liaison |
| Department of Social Development | Head: Social Development |
| Department of Sport, Recreation, Arts and Culture | Head: Sport, Recreation, Arts and Culture |
| Department of Transport | Head: Transport |
| Provincial Treasury | Head: Treasury |
| **Free State** | |
| Department of Agriculture | Head: Agriculture |
| Department of Co-operative Governance and Traditional Affairs | Head: Co-operative Governance and Traditional Affairs |
| Department of Economic Development, Tourism and Environmental Affairs | Head: Economic Development, Tourism and Environmental Affairs |
| Department of Education | Head: Education |
| Department of Health | Head: Health |
| Department of Human Settlements | Head: Human Settlements |
| Department of Police, Roads and Transport | Head: Police, Roads and Transport |
| Department of Public Works | Head: Public Works |
| Department of Rural Development | Head: Rural Development |
| Department of Social Development | Head: Social Development |
| Department of Sport, Arts, Culture and Recreation | Head: Sport, Arts, Culture and Recreation |
| Free State Provincial Treasury | Head: Free State Provincial Treasury |

| ***Column 1***<br>***PROVINCIAL DEPARTMENTS*** | ***Column 2***<br>***HEADS OF PROVINCIAL DEPARTMENTS*** |
|---|---|
| **Gauteng** | |
| Department of Agriculture and Rural Development | Head: Agriculture and Rural Development |
| Department of Community Safety | Head: Community Safety |
| Department of Economic Development | Head: Economic Development |
| Department of Education | Head: Education |
| Department of e-Government | Head: e-Government |
| Department of Health | Head: Health |
| Department of Human Settlements | Head: Human Settlements |
| Department of Infrastructure Development | Head: Infrastructure Development |
| Department of Cooperative Governance and Traditional Affairs | Head: Cooperative Governance and Traditional Affairs |
| Department of Roads and Transport | Head: Roads and Transport |
| Department of Social Development | Head: Social Development |
| Department of Sport, Arts, Culture and Recreation | Head: Sport, Arts, Culture and Recreation |
| Provincial Treasury | Head: Provincial Treasury |
| **KwaZulu-Natal** | |
| Department of Agriculture, Environmental Affairs and Rural Development | Head: Agriculture, Environmental Affairs and Rural Development |
| Department of Arts and Culture | Head: Arts and Culture |
| Department of Community Safety and Liaison | Head: Community Safety and Liaison |
| Department of Co-operative Governance and Traditional Affairs | Head: Co-operative Governance and Traditional Affairs |
| Department of Economic Development and Tourism | Head: Economic Development and Tourism |
| Department of Education | Head: Education |
| Department of Finance | Head: Finance |
| Department of Health | Head: Health |
| Department of Human Settlements | Head: Human Settlements |
| Department of Public Works | Head: Public Works |
| Department of Social Development | Head: Social Development |
| Department of Sport and Recreation | Head: Sport and Recreation |
| Department of Transport | Head: Transport |

| *Column 1*<br>*PROVINCIAL DEPARTMENTS* | *Column 2*<br>*HEADS OF PROVINCIAL DEPARTMENTS* |
|---|---|
| **Limpopo** | |
| Department of Agriculture and Rural Development | Head: Agriculture and Rural Development |
| Department of Co-operative Governance, Human Settlements and Traditional Affairs | Head: Co-operative Governance, Human Settlements and Traditional Affairs |
| Department of Economic Development, Environment and Tourism | Head: Economic Development, Environment and Tourism |
| Department of Education | Head: Education |
| Department of Health | Head: Health |
| Department of Public Works, Roads and Infrastructure | Head: Public Works, Roads and Infrastructure |
| Department of Safety, Security and Liaison | Head: Safety, Security and Liaison |
| Department of Social Development | Head: Social Development |
| Department of Sport, Arts and Culture | Head: Sport, Arts and Culture |
| Department of Transport | Head: Department of Transport |
| Provincial Treasury | Head: Provincial Treasury |
| **Mpumalanga** | |
| Department of Agriculture, Rural Development, Land and Environmental Affairs | Head: Agriculture, Rural Development, Land and Environmental Affairs |
| Department of Community Safety, Security and Liaison | Head: Community Safety, Security and Liaison |
| Department of Co-operative Governance and Traditional Affairs | Head: Co-operative Governance and Traditional Affairs |
| Department of Culture, Sport and Recreation | Head: Culture, Sport and Recreation |
| Department of Economic Development and Tourism | Head: Economic Development and Tourism |
| Department of Education | Head: Education |
| Department of Health | Head: Health |
| Department of Human Settlements | Head: Human Settlements |
| Department of Public Works, Roads and Transport | Head: Public Works, Roads and Transport |
| Department of Social Development | Head: Social Development |
| Provincial Treasury | Head: Provincial Treasury |
| **Northern Cape** | |
| Department of Agriculture, Land Reform and Rural Development | Head: Agriculture, Land Reform and Rural Development |
| Department of Co-operative Governance, Human Settlements and Traditional Affairs | Head: Co-operative Governance, Human Settlements and Traditional Affairs |
| Department of Economic Development and Tourism | Head: Economic Development and Tourism |
| Department of Education | Head: Education |
| Department of Environment and Nature Conservation | Head: Environment and Nature Conservation |
| Department of Health | Head: Health |
| Department Roads and Public Works | Head: Roads and Public Works |
| Department of Social Development | Head: Social Development |
| Department of Sport, Arts and Culture | Head: Sport, Arts and Culture |
| Department of Transport, Safety and Liaison | Head: Transport, Safety and Liaison |
| Provincial Treasury | Head: Provincial Treasury |

| *Column 1*<br>*PROVINCIAL DEPARTMENTS* | *Column 2*<br>*HEADS OF PROVINCIAL DEPARTMENTS* |
|---|---|
| **North West** | |
| Department of Community Safety and Transport Management | Head: Community Safety and Transport Management |
| Department of Culture, Arts and Traditional Affairs | Head: Culture, Arts and Traditional Affairs |
| Department of Economy and Enterprise Development | Head: Economy and Enterprise Development |
| Department of Education and Sport Development | Head: Education and Sport Development |
| Department of Finance | Head: Finance |
| Department of Health | Head: Health |
| Department of Local Government and Human Settlements | Head: Local Government and Human Settlements |
| Department of Public Works and Roads | Head: Public Works and Roads |
| Department of Rural, Environmental and Agricultural Development | Head: Rural, Environmental and Agricultural Development |
| Department of Social Development | Head: Social Development |
| Department of Transport | Head: Transport |
| **Western Cape** | |
| Department of Agriculture | Head: Agriculture |
| Department of Community Safety | Head: Community Safety |
| Department of Cultural Affairs and Sport | Head: Cultural Affairs and Sport |
| Department of Economic Development and Tourism | Head: Economic Development and Tourism |
| Department of Education | Head: Education |
| Department of Environmental Affairs and Development Planning | Head: Environmental Affairs and Development Planning |
| Department of Health | Head: Health |
| Department of Human Settlements | Head: Human Settlements |
| Department of Local Government | Head: Local Government |
| Department of Social Development | Head: Social Development |
| Department of Transport and Public Works | Head: Transport and Public Works |
| Provincial Treasury | Head Official: Provincial Treasury |

## SCHEDULE 3

## PART A

## NATIONAL GOVERNMENT COMPONENTS AND HEADS THEREOF
***(Section 7(2) and (3))***

| ***Column 1***<br>***Name of national government component*** | ***Column 2***<br>***Designation of head of national government component*** | ***Column 3***<br>***Principal national department*** |
|---|---|---|
| Centre of Public Service Innovation | Executive Director: Centre of Public Service Innovation | Department of Public Service and Administration |
| Government Pensions Administration Agency | Chief Executive Officer: Government Pensions Administration Agency | National Treasury |
| Government Printing Works | Chief Executive Officer: Government Printing Works | Department of Home Affairs |
| Government Technical Advisory Centre | Head: Government Technical Advisory Centre | National Treasury |
| Municipal Infrastructure Support Agent | Head: Municipal Infrastructure Support Agent | Department of Cooperative Governance |
| South African Development Partnership Agency | Head: South African Development Partnership Agency | Department of International Relations and Cooperation |

## PART B

## PROVINCIAL GOVERNMENT COMPONENTS AND HEADS THEREOF
***(Section 7(2) and (3))***

| ***Column 1***<br>***Name of provincial government component*** | ***Column 2***<br>***Designation of head of provincial government component*** | ***Column 3***<br>***Principal Office of the Premier or provincial department*** |
|---|---|---|
| Gauteng Infrastructure Financing Agency | Chief Executive Officer: Gauteng Infrastructure Financing Agency | Provincial Treasury |

## Annexure C – Public Finance Management Act, 1999 (PFMA) – Listed public entities

## PUBLIC ENTITIES LISTED IN SCHEDULES 1, 2 & 3 OF THE PFMA

**NOTE:**

Below are the schedules to the PFMA effective from 30 April 2015. The schedules change from time to time as new public entities are listed, classified, re-classified, amalgamated or delisted. For the latest schedules, see the PFMA homepage on National Treasury's website **www.treasury.gov.za**.

| Schedule 1<br>Constitutional Institutions | Schedule 2<br>Major Public Entities |
|---|---|
| 1) The Commission on Gender Equality<br>2) The Commission for the Promotion and Protection of the Rights of Cultural, Religious and Linguistic Communities<br>3) The Financial and Fiscal Commission<br>4) The South African Human Rights Commission<br>5) The Independent Communications Authority of South Africa<br>6) The Independent Electoral Commission<br>7) The Municipal Demarcation Board<br>8) The Pan South African Language Board<br>9) The Public Protector of South Africa | 1) Air Traffic and Navigation Services Company<br>2) Airports Company (ACSA)<br>3) Alexkor Limited<br>4) Armaments Corporation of South Africa Limited (ARMSCOR)<br>5) Broadband Infrastructure Company (Pty) Ltd<br>6) CEF (Pty) Ltd (formerly Central Energy Fund)<br>7) DENEL (Pty) Ltd<br>8) Development Bank of Southern Africa (DBSA)<br>9) ESKOM<br>10) Independent Development Trust (IDT)<br>11) Industrial Development Corporation of South Africa Limited (IDC)<br>12) Land and Agricultural Development Bank of South Africa<br>13) SA Broadcasting Corporation Limited<br>14) South African Express Limited<br>15) SA Forestry Company Limited<br>16) SA Nuclear Energy Corporation Limited<br>17) SA Post Office Limited<br>18) South African Airways Limited<br>19) Telkom SA Limited<br>20) Trans-Caledon Tunnel Authority<br>21) Transnet Limited<br><br>All subsidiaries of the above major public entities |

## .Schedule 3
## Other Public Entities

### *Part A: National Public Entities*

1) Accounting Standards Board
2) Africa Institute of South Africa, Pretoria
3) African Renaissance and International Cooperation Fund
4) Agricultural Research Council
5) Agricultural Sector Education and Training Authority (AGRISETA)
6) Artscape
7) Banking Sector Education and Training Authority
8) Boxing South Africa
9) Breede River Catchment Management Agency
10) Castle Control Board
11) Chemical Industries Education and Training Authority
12) Commission for Conciliation, Mediation & Arbitration
13) Community Schemes Ombud Service
14) Companies and Intellectual Property Commission
15) Companies Tribunal
16) Compensation Fund, including Reserve Fund
17) Competition Commission
18) Competition Tribunal
19) Construction Education and Training Authority
20) Construction Industry Development Board
21) Council for Geoscience
22) Council for Medical Schemes
23) Council for the Built Environment (CBE)
24) Council on Higher Education
25) Cross-Border Road Transport Agency
26) Culture, Arts, Tourism Hospitality and Sports Education and Training Authority
27) Die Afrikaanse Tall Museum
28) Ditsong: Museums of South Africa
29) EDI Holdings (Pty) Ltd
30) Education and Labour Relations Council
31) Education, Training and Development Practices Sector Education and Training Authority
32) Energy and Water Sector Education and Training Authority
33) Estate Agency Affairs Board
34) Fibre Processing Manufacturing Sector Education and Training Authority
35) Film and Publication Board
36) Financial and Accounting Services Training Authority
37) Financial Intelligence Centre
38) Financial Services Board
39) Food and Beverages Manufacturing Industry Sector Education and Training Authority
40) Freedom Park Trust
41) Health and Welfare Sector Education and Training Authority
42) Housing Development Agency (HDA)
43) Human Sciences Research Council (HSRC)
44) Independent Regulatory Board for Auditors
45) Ingonyama Trust Board
46) Inkomati Catchment Management Agency
47) Insurance Sector Education and Training Authority
48) International Marketing Council (IMC)
49) International Trade Administration Commission
50) iSimangaliso WetlandPark
51) Iziko Museums of Cape Town
52) Legal Aid Board
53) Local Government, Water and Related Services Sector Education and Training Authority
54) Luthuli Museum
55) Manufacturing, Engineering and Related Services Education and Training Authority
56) Marine Living Resources Fund
57) Market Theatre Foundation
58) Media Development and Diversity Agency
59) Media, Information and Communication Technologies Sector Education Training Authority
60) Medical Research Council of South Africa (MRC)
61) Mine Health and Safety Council
62) Mining Qualifications Authority
63) Municipal Infrastructure Investment Unit
64) National Agricultural Marketing Council
65) National Arts Council of South Africa
66) National Consumer Commission
67) National Consumer Tribunal
68) National Credit Regulator
69) National Development Agency
70) National Economic, Development and Labour Council
71) National Electronic Media Institute of SA
72) National Empowerment Fund
73) National Energy Regulator of South Africa
74) National Film and Video Foundation
75) National Gambling Board of South Africa
76) National Health Laboratory Service (NHLS)

## Schedule 3
## Other Public Entities

### *Part A: National Public Entities (continued)*

77) National Heritage Council of South Africa
78) National Home Builders Registration Council (NHBRC)
79) National Housing Finance Corporation
80) National Library of South Africa
81) National Lotteries Commission (formerly known as the National Lotteries Board)
82) National Metrology Institute of South Africa
83) National Museum, Bloemfontein
84) National Nuclear Regulator
85) National Regulator for Compulsory Specifications
86) National Research Foundation (NRF)
87) National Student Financial Aid Scheme
88) National Urban Reconstruction and Housing Agency (NURCHA)
89) National Youth Development Agency (NYDA)
90) Nelson Mandela National Museum
91) Office of Health Standards Compliance
92) Office of the Ombudsman for Financial Services Providers
93) Office of the Pension Funds Adjudicator
94) Performing Arts Council of the Free State
95) Perishable Products Export Control Board
96) Ports Regulator of South Africa
97) Private Security Industry Regulatory Authority
98) Productivity SA
99) Public Sector Education and Training Authority
100) Quality Council for Trades and Occupations - QCTO
101) Railway Safety Regulator
102) Road Accident Fund
103) Road Traffic Infringement Agency - RTIA
104) Road Traffic Management Corporation
105) Robben Island Museum, Cape Town
106) Rural Housing Loan Fund
107) Safety and Security Sector Education and Training Authority
108) Servcon Housing Solutions (Pty) Ltd
109) Services Sector Education and Training Authority
110) Small Enterprise Development Agency
111) Social Housing Foundation
112) South African Civil Aviation Authority (CAA)
113) South African Council for Educators
114) South African Diamond and Precious Metals Regulator
115) South African Heritage Resources Agency
116) South African Library for the Blind
117) South African Local Government Association (SALGA)
118) South African Maritime Safety Authority
119) South African National Accreditation System
120) South African National Biodiversity Institute (SANBI)
121) South African National Energy Development Institute
122) South African National Parks (SANPARKS)
123) South African National Space Agency
124) South African Qualifications Authority (SAQA)
125) South African Revenue Service (SARS)
126) South African Social Security Agency
127) South African Tourism
128) South African Weather Service
129) Special Investigation Unit
130) State Information Technology Agency (SITA)
131) Technology Innovation Agency (TIA)
132) The Co-Operative Banks Development Agency
133) The National English Literary Museum
134) The National Radioactive Waste Disposal Institute
135) The National Skills Fund
136) The Playhouse Company
137) The Social Housing Regulatory Authority (SHRA)
138) The South African Institute for Drug-free Sport
139) The South African National Roads Agency (SANRAL)
140) The South African State Theatre
141) Thubelisha Homes
142) Transport Education and Training Authority
143) uMalusi Council for Quality Assurance in General and Further Education and Training
144) uMsunduzi Museum
145) Unemployment Insurance Fund (UIF)
146) Universal Service and Access Agency of South Africa
147) Universal Service and Access Fund
148) Urban Transport Fund
149) Vredefort Dome World Heritage Site
150) War Museum of the Boer Republics
151) Water Research Commission
152) Wholesale and Retail Sector Education and Training Authority
153) William Humphreys Art Gallery
154) Windybrow Centre

All subsidiaries of the above national public entities

## Schedule 3
## Other Public Entities

### *Part B: National Government Business Enterprises*

1) Amatola Water Board
2) Bloem Water
3) Council for Scientific and Industrial Research (CSIR)
4) Export Credit Insurance Corporation of South Africa Limited
5) Inala Farms (Pty) Ltd
6) Khula Enterprises Finance Limited
7) Lepelle Northern Water
8) Magalies Water
9) Mintek (formerly the Council for Mineral Technology)
10) Mhlathuze Water
11) Ncera Farms (Pty) Ltd
12) Onderstepoort Biological Products Limited
13) Overberg Water
14) Passenger Rail Agency of South Africa (PRASA)
15) Public Investment Corporation Limited (PIC)
16) Rand Water
17) SA Bureau of Standards (SABS)
18) Sasria Limited
19) Sedibeng Water
20) Sentech Limited
21) State Diamond Trader
22) Umgeni Water

All subsidiaries of the above government business entities

### *Part C: Provincial Public Entities*

#### *Eastern Cape:*

1) Eastern Cape Arts Council
2) Eastern Cape Gambling and Betting Board
3) Eastern Cape Liquor Board
4) Eastern Cape Parks and Tourism Agency (ECPTA)
5) Eastern Cape Rural Development Agency
6) Eastern Cape Socio-Economic Consultative Council
7) Eastern Cape Youth Commission

#### *Limpopo:*

1) Limpopo Appeal Tribunals
2) Limpopo Development Tribunals
3) Limpopo Economic Development Agency
4) Limpopo Gambling Board
5) Limpopo Housing Board
6) Limpopo Liquor Board
7) Limpopo Local Business Centres
8) Limpopo Panel of Mediators
9) Limpopo Planning Commission
10) Limpopo Roads Agency
11) Limpopo Tourism and Parks Board

#### *KwaZulu-Natal:*

1) Agri-Business Development Agency
2) Amafa AkwaZulu Natali
3) Dube Tradeport Corporation
4) Ezemvelo Kwazulu-Natal Wildlife
5) KwaZulu-Natal Film Commission
6) KwaZulu-Natal Gaming and Betting Board
7) KwaZulu-Natal House of Traditional Leaders
8) KwaZulu-Natal Liquor Authority
9) KwaZulu-Natal Provincial Planning and Development Commission
10) KwaZulu-Natal Tourism Authority
11) Natal Sharks Board
12) Royal Household Trust
13) Trade and Investment KwaZulu-Natal
14) uMsekeli Municipal Support Services

#### *Gauteng:*

1) Gauteng Enterprise Propeller
2) Gauteng Gambling Board
3) Gauteng Growth and Development Agency
4) Gauteng Tourism Authority (GTA)
5) Gautrain Management Agency
6) XHASA ATC Agency

**Schedule 3**
**Other Public Entities**

***Part C: Provincial Public Entities (continued)***

***Western Cape:***

1) Wc Commissioner for the Environment
2) WC Commission for the Environment
3) WC Cultural Commission
4) WC Gambling and Racing Board
5) WC Investment and Trade Promotion Agency
6) WC Language Committee
7) WC Liquor Board
8) WC Nature Conservation Board
9) WC Provincial Development Council

***Mpumalanga:***

1) Mpumalanga Gambling Board
2) Mpumalanga Liquor Authority
3) Mpumalanga Regional Training Trust
4) Mpumalanga Tourism and Parks Board

***Free State:***

1) Free State Gambling and Liquor Authority (FSGLA)
2) Free State Tourism Authority
3)

***North West:***

1) Invest North West
2) Mmabana Arts, Culture and Sport Foundation
3) NW Eastern Region Entrepreneurial Support Centre
4) NW Gambling Board
5) NW Housing Corporation
6) NW Parks and Tourism Board
7) NW Provincial Aids Council
8) Provincial Arts and Culture Council
9) North West Provincial Heritage Resources Authority
10) NW Youth Development Trust

***Northern Cape:***

1) Kalahari Kid Corporation (KKC)
2) Mc Gregor Museum (Kimberley)
3) Northern Cape Economic Development, Trade and Investment Promotion Agency
4) Northern Cape Gambling Board
5) Northern Cape Liquor Board
6) Northern Cape Tourism Authority

All subsidiaries of any of the above provincial public entities

***Part D: Provincial Government Business Enterprises***

***Eastern Cape:***

1) East London Industrial Development Zone Corporation
2) Eastern Cape Development Corporation
3) Mayibuye Transport Corporation

***KwaZulu-Natal:***

1) Cowslip Investments (Pty) Ltd
2) Ithala Development Finance Corporation
3) Mjindi Farming (Pty) Ltd
4) Mpendle-Ntambanana Agricultural Company (Pty) Ltd
5) Richards Bay Industrial Development Zone

***Western Cape:***

1) Casidra (Pty) Ltd

***North West:***

1) Mafikeng Industrial Development Zone (Pty Limited)
2) NW Development Corporation
3) NW Transport Investments (Pty) Ltd

***Free State:***

1) Free State Development Corporation

***Limpopo:***

1) Gateway Airport Authority Limited
2) Northern Province Development Corporation

***Mpumalanga:***

1) Mpumalanga Economic Growth Agency

All subsidiaries of any of the above provincial government enterprises

**Annexure D – Explanatory examples**

**Example 1 – Payment to a municipality for an actual supply of land used for non-taxable purposes**

Department of Rural Development and Reform (DRDLR) (previously known as Department. of Land Affairs (DLA)) pays a municipality an amount of money to transfer a piece of vacant land (commonage) belonging to the municipality to a community trust in the area. DRDLR also makes funds available to the community trust to build a community hall on the land.

*Before 1 April 2005*

Since the supply of the vacant land would not have constituted an actual taxable supply by the municipality there would have been no deemed supply by the municipality to the DLA (as it was known at the time). The supply would, however, have been non-taxable as the land was not used for "enterprise" purposes at that time. The payment for the land would have been reflected as an out-of-scope receipt which would be reflected in Block 3 of the municipality's VAT 201 return and not in Block 2 (zero-rated supplies). Since the community trust is not a vendor and is not making any taxable supplies, there is also no deemed supply to the DLA on receipt of the funds to build the community hall.

*On or after 1 April 2005*

The supply by the municipality to a third person (in this case, the community trust) would be taxable at the standard rate as it is not a "grant". No deemed supply arises as there is an actual supply under section 7(1)(*a*).

*On or after 31 October 2009*

As the amendments to the VAT Act which were introduced with effect from 1 April 2005 did not provide for the zero-rating of certain DRDLR transactions, sections 11(1)(*s*) and 11(1)(*t*) were inserted in the VAT Act with effect from 31 October 2009 to provide that the supply of goods, (being fixed property) acquired by qualifying beneficiaries or the DRDLR in terms of the Programmes is subject to VAT at the zero rate. The zero-rating only applies to the extent that the transactions are financed from grants or subsidies to which beneficiaries are entitled from the DRDLR and does not apply to any additional consideration which may be payable by the beneficiary to the vendor supplying the fixed property

In this example, the supply of the fixed property by the municipality to the community trust would qualify to be taxed at the zero rate under sections 11(1)(*t*).

**Example 2 – Procurement of supplies by a public authority**

The Department of Public Works (DPW) pays an outside contractor an amount to paint its office premises and to install an air-conditioning system.

*Before 1 April 2005*

Since DPW is actually receiving goods and services in return for the payment made, the payment does not qualify as a transfer payment. Section 8(5) does not apply and DPW will have to include the VAT that it will be charged in the total cost which it has budgeted to cover the project.

*On or after 1 April 2005*

Same as above.

**Example 3 – Subsidy paid by a public authority to a municipality for taxable purposes**

Department of Water Affairs (DWA) pays a subsidy to a municipality to enable that municipality to sink boreholes and provide necessities such as taps, piping and water storage facilities to enable the poor to get access to free water which will be provided by the municipality. The subsidy was paid in addition to the equitable share paid to the municipality under the DOR Act, but was not paid in terms of that act.

*Before 1 April 2005*

Since DWA is a public authority and the payment is in respect of the taxable supply of water under paragraph (*c*)(i) and (iii) of the definition of "enterprise" (as it read at the time) by the municipality to certain members of the community, the municipality is deemed to make a supply to DWA under section 8(5). The payment would be zero-rated if it qualified as a "transfer payment" (as defined at the time), but would have been subject to VAT at the standard rate if it was appropriated in terms of the DOR Act.

The fact that this service is provided for free to a specific sector of the community does not alter the fact that the supply of water by the municipality is a taxable supply for no consideration under section 10(23). Furthermore, it does not matter that the funds are expended on capital infrastructure rather than operational costs. As long as (and to the extent that) the capital infrastructure is for taxable supplies, that receipt qualified as a zero-rated "transfer payment".

If the municipality incurred VAT-inclusive expenses to sink the boreholes and to erect the water pipe infrastructure, or if it commissioned a VAT registered contractor to carry out the work, it would have been entitled to deduct input tax in this regard. The receipt by the contractor would not qualify as a zero-rated grant, since the municipality paid for actual services rendered.

*On or after1 April 2005*

Same as the above, except that the payment constitutes a "grant" and is zero-rated under section 8(5A) read together with section 11(2)(*t*). If the payment was included in the municipality's "equitable share" grant in terms of the DOR Act, it will also qualify for the zero rate under these provisions.

**Example 4 – Gratuitous payment by a municipality to a welfare organisation**

A municipality pays an amount of money to a welfare organisation (vendor) to further their cause of assisting the local rural community by educating them about sustainable development.

*Before1 April 2005*

The supplies made by the welfare organisation to the local community are not exempt supplies under section 12(*h*), but are taxable supplies, even if made for no consideration. Since the welfare organisation does not make any actual supplies to the municipality, section 8(5) will deem the payment received by the welfare organisation to be in respect a taxable supply of services. However, as the payment is not made by a public authority, it cannot be a "transfer payment", and hence it cannot be zero-rated under section 11(2)(*p*). However, the payment would qualify for the zero-rating under section 11(2)(*n*) as the recipient of the payment is a "welfare organisation" and the payment is for the carrying on of a welfare activity.

*On or after1 April 2005*

Same as the above, except that a welfare organisation is regarded as a "designated entity". The payment also constitutes a "grant" and is zero-rated under section 8(5) (as amended) read together with section 11(2)(*n*) (as amended).

In a case where a municipality procures goods or services from a welfare organisation or pays for a specific supply to be made to another person, there is no deemed supply which arises under either sections 8(5) or 8(5A). If the welfare organisation is registered for VAT, the supplies so procured would be subject to VAT at the standard rate under section 7(1)(*a*) under the normal rules.

**Example 5 – Disaster relief payments**

National Treasury is instructed by Parliament to make available emergency funds to be paid to certain farmers in drought stricken regions of the country to replace damaged or lost standing-crops and livestock. Payments are made available via the Department of Rural Development and Land Reform (DRDLR) (formerly known as the Department of Land Affairs) on application.

*Before 1 April 2005*

Any farmer (vendor) who applied for and received the subsidy (grant-in-aid) would be deemed to make a taxable supply of a service under section 8(5) to the DLA (as it was known at the time). Since the goods which were lost or damaged were used for taxable purposes by the farmers and the DLA does not receive any actual supply of goods or services in return, the subsidy payment would have qualified as a "transfer payment" and the receipt would have been zero-rated in the hands of the farmer (vendor). There is no VAT implication for recipients who are not vendors.

*On or after 1 April 2005*

Same as the above, except that the payment constitutes a "grant" and is zero-rated under section 8(5A) read together with section 11(2)(*t*) (provided that the farming enterprise is not a "designated entity"). However, if the disaster relief was in the form of compensation paid by a public authority in terms of section 19 of the Animal Diseases Act 35 of 1984 for the supply of a "controlled animal or thing" as defined in that Act to that public authority, the supply of the affected animals to the Department did not qualify to be charged with VAT at the zero rate.

*On or after 7 February2007*

Same as above, except that if the disaster relief was in the form of compensation paid in terms of section 19 of the Animal Diseases Act 35 of 1984 the supply of the affected animals would qualify to be charged with VAT at the zero rate under section 11(1)(*r*).

**Example 6 – Infrastructure grant paid to a municipality for roads and street lighting**

The Department of Transport (DoT) makes a payment to a municipality to provide public roads and street lighting for the general public in the municipality's jurisdiction.

*Before 1 April 2005*

The supply of public roads and street lighting by a municipality is usually funded out of the municipality's rates account. Such supplies were therefore not normally considered to be taxable as contemplated in paragraph (*c*)(iv) of the definition of "enterprise" (as it read at the time). No deemed supply would therefore have arisen between the municipality and DoT under section 8(5) in regard to that payment and it would not have been zero-rated under section 11(2)(*p*), even though it may have qualified as a "transfer payment".

It follows that the municipality would not have been able to deduct any input tax on any goods or services acquired in order to provide the public roads and street lighting to the general public in this case.

If the municipality concerned charged a flat rate for its services as contemplated under section 8(6)(*a*), all the goods and services provided by that municipality would have been deemed to be taxable. In such a case, the deemed supply to DoT would have been zero-rated under section 11(2)(*p*). The municipality in this instance would have been allowed to deduct the input tax incurred in providing public roads and street lighting.

*On or after 1 April 2005 but before 1 July 2006*

Same as above, except that a municipality is not a "designated entity". Consequently, with the amendments to section 8(5), this section no longer applies to the municipality. If the grant payment is in respect of the municipality's taxable supplies (for example, a municipality that charges the "flat rate"), the payment will be zero-rated under section 11(2)(*t*) read with section 8(5A). Alternatively, if the payment is for the municipality to make exempt supplies, the payment will be out-of-scope for VAT purposes.

*On or after 1 July 2006*

With effect from 1 July 2006, paragraph (*c*) of the definition of "enterprise" and the definition of "local authority" were deleted. The effect is that from 1 July 2006, most of the supplies by a municipality became taxable at the standard rate under paragraph (*a*) of the definition of "enterprise". Therefore, the payment is regarded as a zero-rated grant under section 11(2)(*t*) read with section 8(5A) to the extent that it is received for enterprise purposes by the municipality. It follows that the VAT incurred in providing those facilities may be deducted as input tax, subject to the normal documentary requirements being met.

**Example 7 – Transport subsidy paid partially for taxable purposes**

Department of Transport (DoT), as part of its recapitalisation programme to scrap 10 000 old taxis makes a payment (scrapping allowance) of R50 000 to taxi owners for each legally-registered old minibus that was scrapped

*Before 1 April 2005*

No such payments were made before 1 April 2005.

*On or after 1 April 2005*

DoT is a public authority, but some of the recipients concerned may be registered for VAT as they make both taxable supplies (zero-rated international transport) and exempt supplies (local fare-paying passenger transport) under sections 11(2)(*a*) and 12(*g*) respectively. Each vendor is therefore deemed to make a supply to DoT under section 8(5A) only to the extent that it is in respect of the taxable part of that vendor's business.

For instance, assume the following facts regarding one of the recipients (vendor):

- Payment of R50 000 received to buy a new taxi.
- The new taxi costs R228 000 (including VAT) and will be used 70% for taxable supplies (international bus transport) and 30% for exempt supplies (local taxi transport).

In this example, the vendor will zero-rate 70% of the payment (R35 000) under section 11(2)(*t*) as it will constitute a "grant" (declared in Block 2 on the VAT 201 return) received for taxable purposes. The balance (R15 000) is declared in Block 3 of the VAT 201 return as non-taxable (out-of-scope) income. The vendor will be allowed to deduct input tax as follows when purchasing the new taxi from a vendor:

R228 000 × 14 / 114 × 70% = <u>R19 600</u>.

The above example illustrates a partial zero-rating, but the most common situation is that no deemed supply will arise at all, as the payment in most cases will relate exclusively to exempt activities (local passenger transport by road).

If the taxi owner is registered for VAT in respect of other taxable supplies, but does not make any taxable supplies with the taxi, the entire receipt (R50 000) must be declared in Block 3 of the VAT 201 return as non-taxable (out-of-scope) income. No input tax may be deducted by the vendor when buying the new taxi as the expense is not incurred in the course or furtherance any taxable supplies made by that vendor in that case.