BINDING GENERAL RULING (VAT): NO. 4 (Issue 3)

DATE: 27 March 2015

ACT : VALUE-ADDED TAX ACT NO. 89 OF 1991
SECTION : SECTION 1(1) – DEFINITION OF "INPUT TAX"
SUBJECT : APPORTIONMENT METHODOLOGY TO BE APPLIED BY A MUNICIPALITY

Preamble

For the purposes of this ruling –

- **"BGR"** means a binding general ruling issued under section 89 of the Tax Administration Act No. 28 of 2011;
- **"municipality"** means any municipality falling within any of the categories of municipalities described in section 155 of the Constitution of the Republic of South Africa, 1996;
- **"section"** means a section of the VAT Act unless otherwise stated;
- **"VAT"** means value-added tax;
- **"VAT Act"** means the Value-Added Tax Act No. 89 of 1991; and
- any other word or expression bears the meaning ascribed to it in the VAT Act.

1. Purpose

This BGR –

- prescribes the apportionment method, as contemplated in section 17(1), that a municipality must use to determine the amount of VAT which may be deducted as input tax on any goods or services acquired for a mixed purpose;[1] and
- replaces and withdraws BGR 4 (Issue 2) dated 25 March 2013 "Apportionment Methodology to be Applied by Category A and B Municipalities".

2. Background

VAT must be imposed at the standard rate under section 7(1)(*a*) on supplies made in the course or furtherance of carrying on an enterprise. However, the levying of VAT is subject to certain exemptions and exceptions. Some supplies made by a municipality are subject to VAT at 0% under section 11 (for example, grants, municipal property rates etc), or exempt from VAT under section 12 (for example, the transportation of passengers in a bus, the rental of dwellings etc).

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[1] For purposes of this BGR the acquisition of goods or services partly for the purpose of consumption, use or supply in the course of making taxable supplies and partly for another intended use will be referred to as a "mixed purpose".

In addition, there are some supplies and some forms of income that fall outside the scope of VAT. This include, for example –

- certain supplies that are not made in the course or furtherance of the municipality's enterprise such as the sale of assets on which input tax was denied under section 17(2) or that were used to conduct exempt supplies;[2] and
- certain income streams such as dividends, statutory fines and penalties that do not constitute consideration for any supply of goods or services made by the municipality.[3]

In this regard the *VAT 419 – Guide for Municipalities* sets out the application of the VAT Act to, amongst others, supplies made by and to municipalities.

3. The law and its application

The definition of "input tax" requires the principle of "direct attribution" to be applied. This means that the expense must first be allocated according to the intended purpose for which the expense is incurred, that is, whether it is related wholly to the making of taxable supplies or wholly to the making of exempt or out-of-scope supplies. Expenses that are incurred partly for the purpose of making taxable supplies must be allocated to a mixed purpose.

The VAT incurred on expenses acquired for a mixed purpose may be deducted as input tax to the extent determined in accordance with an apportionment method as contemplated in section 17(1) (that is, determined in accordance with a ruling contemplated in section 41B or Chapter 7 of the TaxAdministration Act, 2011).

4. Ruling

4.1 A Municipality must use the turnover-based method of apportionment to determine the amount of VAT to be deducted as input tax on the acquisition of goods or services for a mixed purpose.

4.2 The apportionment formula (the Formula) which must be applied to determine the amount of input tax contemplated in **4.1** is as follows:

$$y = \frac{a}{a + b + c} \times \frac{100}{1}$$

Where:

"y" = the apportionment percentage/ratio;

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

"b" = the value of all exempt supplies made during the period, excluding interest earned on funds for day-to-day operations held in for example a current account at a bank; and

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[2] These are supplies which are neither taxable nor exempt. They are generally referred to as "out-of-scope supplies".

[3] These income streams are generally referred to as "income from non-supplies".

"c" = the sum of any other amounts not included in "a" or "b" in the formula, that were received or accrued during the period (whether for a supply or not, for example, income received for out-of-scope supplies).

Notes:

1. The term "value" excludes any VAT component.
2. In the Formula, "c" will typically include, but is not limited to, items such as statutory fines, penalties, dividends etc. However, traffic fines are only included in "c" to the extent that payment has actually been received by the municipality.
3. Exclude from the calculation the value of any capital goods or services supplied, unless supplied under a rental agreement[4] (that is, not an instalment credit agreement[5]).
4. Exclude from the calculation the value of any goods or services supplied where input tax on those goods or services was specifically denied under section 17(2).
5. The apportionment percentage should be rounded off to 2 decimal places.
6. Where the Formula yields a result equal to 95% or more, the full amount of VAT incurred for a mixed purpose may be deducted (the *de minimis* rule).

4.3 The following requirements and conditions apply in determining the amounts to be included in the Formula:

4.3.1 A grant that is received partly for taxable purposes and partly for non-taxable purposes must be attributed accordingly. For example, if 70% of a grant is for subsidising the taxable supply of water and electricity to customers and 30% is for subsidising the municipality's exempt public transport business, the grant amount will have to be split into its respective taxable and non-taxable components in accordance with section 10(22). In this example, 70% of the grant amount will be subject to VAT at the zero rate and will be included in "a" in the Formula. The remaining 30% of the grant will be applied for exempt purposes and will be included in "b" in the Formula.

4.3.2 Notwithstanding any permission which may have been granted by the Commissioner to allow a municipality to account for VAT on the payments basis under section 15(2)(*a*)(v), the amounts to be included in "a", "b" and "c" in the Formula for each tax period and for the annual adjustment contemplated in **4.3.3** are to be calculated on the invoice basis and in accordance with the principles set out in the Accounting Standards Board's Standard of Generally Recognised Accounting Practice (GRAP) on *Revenue from Non-exchange Transactions (Taxes and Transfers)*, commonly referred to as GRAP 23. In terms of GRAP 23, income from government grants and subsidies is only recognised when the conditions (if any) are met. Grant income will therefore only be included in the Formula to the extent that such funds are reflected in the income statement of the municipality for the financial year concerned.

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[4] Refer to the definition of "rental agreement" in section 1(1).
[5] Refer to the definition of "instalment credit agreement" in section 1(1).

4.3.3 Although the apportionment percentage is applied in each tax period, for practical purposes, a municipality may calculate the percentage based on the previous year's financial statements. The percentage so calculated must then be applied in every tax period throughout the new financial year as an estimate. The apportionment percentage that was used as an estimate must be re-calculated in accordance with the municipality's audited financial statements and the necessary VAT adjustment made within six months after the municipality's financial year-end.

4.3.4 A municipality that is unable to perform the re-calculation and adjustment within the six-month period referred to in **4.3.3** must approach the Commissioner and request an extension by submitting a VAT ruling application by e-mail to **VATRulings@sars.gov.za** or by facsimile to 086 540 9390. All ruling applications made under section 41B must comply with section 79 of the Tax Administration Act, 2011, excluding section 79(4)(*f*) and (*k*) and (6).

4.3.5 The formal assignment of functions by national or provincial government falls within the ambit of the "enterprise" activities carried on by a municipality, provided the activity does not fall within the ambit of section 12. Any consideration charged, must be included in "a" in the Formula. Any payment received as a result of the national or provincial government providing financial assistance to enable the municipality to carry out the formally assigned activity is regarded as a "grant" as defined and must be included in "a" in the Formula.

4.3.6 The activities for which a municipality is appointed as agent by provincial government do not fall within the ambit of the enterprise carried on by the municipality. Only the amount charged for the taxable supply of such agency service to provincial government must be included in "a" in the Formula.

4.4 The VAT incurred and paid for directly on the supply of goods or services associated with provincial government mandates, referred to as "unfunded mandates", is regarded as being incurred in the course or furtherance of the municipality's enterprise, provided the provincial government mandated activity is not exempt under section 12. The VAT may be deducted in full when the expenses concerned are incurred wholly for purposes of use, consumption or supply in the course of making taxable supplies. Alternatively, the VAT may be deducted in part in accordance with the Formula if the expenses concerned are incurred for mixed purposes.

4.5 The deduction of input tax in all cases is subject to the documentary and other requirements set out in sections 16(2), 16(3), 17 and 20 being met.

4.6 The Commissioner may, on written application, consider the exclusion of **extraordinary income**[6] which may create a distortion in the Formula. The written application for a VAT ruling under section 41B must be submitted to the centralised e-mail address or facsimile number referred to in **4.3.4**.

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6 This would generally be non-recurring income due to exceptional circumstances.

5. Period for which this ruling is valid

This BGR is effective from 1 July 2014 and will apply until it is withdrawn or the relevant legislation is amended.

Group Executive: Interpretation and Rulings
Legal and Policy Division
SOUTH AFRICAN REVENUE SERVICE
Date of 1st issue : 21 January 2010
Date of 2nd issue : 25 March 2013