BINDING GENERAL RULING (VAT) NO: 4 (Issue 2)

DATE: 25 March 2013

ACT : VALUE-ADDED TAX ACT, NO. 89 OF 1991 (the VAT Act)
SECTION : SECTION 1(1) – DEFINITION OF "INPUT TAX"
SUBJECT : APPORTIONMENT METHODOLOGY TO BE APPLIED BY CATEGORY A AND B MUNICIPALITIES

Preamble

For the purposes of this ruling –

- **"BGR"** means a binding general ruling issued under section 89 of the TA Act;
- **"Category A Municipality"** means a municipality that has the exclusive authority to administer and make rules in its area being the "metropolitan area";
- **"Category B Municipality"** means a 'local municipality' that shares municipal executive and legislative authority, i.e. the authority to administer and make rules, in its area with a category C Municipality, being a 'district municipality', within whose area it falls;
- **"Municipality"** means a Category A Municipality or a Category B Municipality;
- **"section"** means a section of the VAT Act unless otherwise stated;
- **"TA Act"** means Tax Administration Act No. 28 of 2011; and
- any word or expression bears the meaning ascribed to it in the VAT Act.

1. Purpose

This BGR –

- gives notice of the apportionment method, as contemplated in section 17(1), that a Municipality must use to determine the amount of VAT to be allowed as input tax in respect of the acquisition of goods or services for a mixed purpose;[1]
- modifies BGR 4 "Apportionment Methodology to be Applied by Category A Municipalities" dated 21 January 2010; and
- withdraws BGR 10 "Apportionment Methodology to be Applied by Category B Municipalities" dated 28 March 2012.

[1] For purposes of this document 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".

2. Background

A Municipality must generally levy VAT at 14%, in terms of section 7(1)(*a*), on all supplies made in the course or furtherance of carrying on an enterprise. However, this levying of VAT is subject to certain exemptions and exceptions. Some supplies 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.). In addition, there are some supplies which fall outside the scope of VAT (for example, dividends, statutory fines and penalties).[2]

In this regard the *Guide for Municipalities (VAT 419)* sets out the application of the VAT Act in respect of, 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 TA Act).

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 in respect of the acquisition of goods or services for a mixed purpose.

4.2 The apportionment formula (the Formula) to 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, including interest earned on, for example, investing surplus funds; and

"c" = the sum of any other amounts not included in "a" or "b" in the formula, which were received or accrued during the period (whether in respect

[2] These supplies are generally referred to as "out-of-scope supplies" or "non-supplies" and indicate a supply that is made by a municipality that is neither in the course or furtherance of that municipality's enterprise nor is it an exempt supply.

of a supply or not, for example, income received in respect of 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.
3. Exclude from the calculation the value of any capital goods or services supplied, unless supplied under a rental agreement[3] (that is, not an instalment credit agreement)[4].
4. Exclude from the calculation the value of any goods or services supplied where input tax on those goods or services was specifically denied in terms of 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 A Municipality, for purposes of determining the amounts to be included in the Formula, is required to comply with the following conditions:

4.3.1 A grant that is received for partly taxable and other than taxable supplies must be attributed accordingly. For example, if 70% of a grant is for subsidising the supply of water and electricity to customers, which is a taxable supply and 30% is for subsidising the municipality's public transport business, which is an exempt supply, the grant will have to be split under section 10(22). Therefore, 70% will be subject to VAT at the zero rate and will be included in "a" in the Formula, and the remaining 30% of the grant will be applied for exempt supplies and will be included in "b" in the Formula.

4.3.2 A Municipality is required to re-calculate the apportionment percentage based on the actual attribution of all grants, within three months after its financial year end, which may result in an adjustment to the input tax or output tax. A Municipality that is unable to perform the re-calculation within the stipulated timeframe 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 in terms of section 41B must comply with section 79 of the TA Act, excluding sections 79(4)(*f*) and (*k*) and (6).

4.3.3 The assignment of functions by national or provincial government falls within the ambit of the "enterprise" activities carried on by a Municipality, provided that 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 assigned activity is regarded as a "grant" as defined and must be included in "a" in the Formula.

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

4.3.4 The activities in respect of 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 in respect of the taxable supply of such agency service to provincial government must be included in “a” in the Formula.

4.3.5 Interest earned on, for example, investing surplus funds or overdue accounts, must be included in “b” 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 that the provincial government mandate activity is not exempt in terms of section 12. The VAT may be deducted in full where incurred wholly for purposes of use, consumption or supply in the course of making taxable supplies or deducted in accordance with the formula if incurred for mixed purposes, subject to sections 16(2), 16(3), 17 and 20.

The Commissioner may, on written application, consider **extraordinary income**[5] which may create a distortion in the Formula. The written application for a VAT ruling in terms of section 41B must be submitted to the centralised e-mail address of facsimile number referred to in **4.3.2**.

5. Period for which this ruling is valid

This BGR is effective from 1 April 2013 and is valid for an indefinite period.

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[5] This would generally be non-recurring income due to exceptional circumstances that are unlikely to be repeated.