SOUTH AFRICAN REVENUE SERVICE

BINDING GENERAL RULING (VAT) NO: 4

DATE: 21 January 2010

ACT : VALUE-ADDED TAX ACT, NO. 89 OF 1991 (the VAT Act)
SECTION : SECTION 1 – DEFINITION OF "INPUT TAX" AND SECTION 17(1)
SUBJECT : APPORTIONMENT METHODOLOGY TO BE APPLIED BY CATEGORY A MUNICIPALITIES

1. Purpose

The purpose of this binding general ruling is to prescribe the apportionment method, as contemplated in section 17(1), that Category A[1] municipalities must use to calculate the amount of value-added tax (VAT) to be allowed as input tax in respect of the acquisition of goods or services for a mixed purpose.[2]

2. Background

The Small Business Tax Amnesty and Amendment of Taxation Laws Act, No. 9 of 2006, effected certain amendments to the VAT Act with the purpose of simplifying municipalities' accounting and tax records. As a result, certain supplies previously made by municipalities which were exempt or non-taxable for VAT purposes became taxable at the standard or zero rate after 1 July 2006.

The effect of the amendments is that the activities of a municipality fall within the scope of paragraph (*a*) of the definition of "enterprise" in section 1. The amendments therefore fundamentally broadened the scope of taxable supplies made by a municipality. A municipality is now treated for VAT purposes in more or less the same manner as any other vendor.

3. The law and its application

The statutory framework (that is, the definition of "input tax" in section 1) requires the principle of "direct attribution" to be applied, in that VAT must be attributed in the first instance according to whether it is wholly related to the making of taxable supplies or wholly to the making of exempt or out of scope supplies. VAT that cannot be attributed must be allocated to a mixed purpose.

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[1] A "Category A Municipality" is a municipality that has the exclusive authority to administer and make rules in its area being the "metropolitan area".

[2] 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".

A municipality, being a vendor, may deduct the full amount of the VAT incurred on the acquisition of goods or services, as input tax, where the acquisition is wholly for the purpose of consumption, use or supply in the course of making taxable supplies and may not deduct the VAT incurred on the acquisition of goods or services, as input tax, where the acquisition is for the purpose of consumption, use or supply in the course of making wholly exempt or wholly out of scope supplies.[3] The VAT incurred on the acquisition of goods or services where the acquisition is for a mixed purpose may also be deducted as input tax to the extent determined in accordance with an approved apportionment method as contemplated in section 17(1).

4. Ruling

4.1 Category A municipalities must use the turnover-based method of apportionment to calculate 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;
"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; and
"c" = the sum of any other amounts not included in "a" or "b" in the formula, which were received or which accrued during the period (whether in respect 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. "c" in the Formula will typically include, but not limited to, items such as dividends and statutory fines (if any).
3. Exclude from the calculation the value of any capital goods or services supplied, unless supplied under a rental agreement/operating lease (that is, not a financial lease[4] or instalment sale agreement).
4. Exclude from the calculation the value of any goods or services supplied where input tax on those goods or services was specifically denied.
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 claimed (the *de minimis* rule).

[3] An out of scope supply refers to 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. This term is also synonymous with the term "non-supply", for example, dividends and statutory fines.

[4] Means paragraph (*b*) of the definition of "instalment credit agreement" in section 1.

4.3 Category A municipalities, for purposes of determining the amounts to be included in the Formula, are required to comply with the following arrangements:

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

4.3.2 Category A municipalities are required to re-calculate the apportionment percentage based on the actual attribution of all grants, within three months after their financial year-end, which may result in an increase or decrease to input tax. A Category A municipality that is unable to perform the re-calculation within the stipulated timeframe must approach the South African Revenue Service (SARS) to request an extension.

4.3.3 The assignment of functions by national or provincial government falls within the ambit of the "enterprise" activities carried on by that 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 Category A municipality to carry out the assigned activity is regarded as a "grant" as defined and must be included in "a" in the Formula.

4.3.4 The activities in respect of which Category A municipalities are appointed as agent by provincial government do not fall within the ambit of the enterprise carried on by Category A municipalities. 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" 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 that 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.

4.5 Category A municipalities are required to exclude the value of the supply of capital goods or services (unless supplied under a rental agreement/operating lease) and the value of the supply of goods or services where input tax was specifically denied. The value of all other taxable supplies, exempt supplies and non-supplies must be included in the Formula.

5. Period for which this ruling is valid

This ruling is a binding general ruling issued in accordance with section 76P of the Income Tax Act, No. 58 of 1962, as made applicable to the VAT Act by section 41A. This binding general ruling is valid until 31 June 2014.

Any ruling issued to Category A municipalities approving a method of apportionment other than that which is confirmed in this ruling, is hereby withdrawn. The effective date of withdrawal is 1 July 2010.

Legal and Policy Division
SOUTH AFRICAN REVENUE SERVICE