

BINDING GENERAL RULING (VAT) 74

DATE: 3 October 2024

ACT : VALUE-ADDED TAX ACT 89 OF 1991
SECTION : SECTION 1(1) DEFINITIONS OF “GRANT” AND “INPUT TAX” AND SECTIONS 7(1)(a), 8(5A), (11)(2)(f) AND 54
SUBJECT : VAT TREATMENT OF CERTAIN SUPPLIES OF GOODS OR SERVICES MADE BY A MUNICIPALITY TO A NATIONAL OR PROVINCIAL GOVERNMENT

Preamble

For the purposes of this ruling –

- **“BGR”** means a binding general ruling issued under section 89 of the Tax Administration Act 28 of 2011;
- **“section”** means a section of the VAT Act;
- **“VAT”** means value-added tax;
- **“VAT Act”** means the Value-Added Tax Act 89 of 1991;
- **“Constitution”** means the Constitution of the Republic of South Africa, Act 108 of 1996;
- **“Republic”** means the Republic of South Africa; and
- any word or expression bears the meaning ascribed to it in the VAT Act.

The table in **4** does not apply to any supplies that are deemed to be made, under section 8(23), by municipalities to the extent of any payment made to a municipality in terms a national housing programme contemplated in the Housing Act 107 of 1997.

1. Purpose

This BGR sets out the VAT treatment of supplies of goods or services that are made by municipalities to national or provincial government under each method of contracting. This BGR does not purport to determine the contractual agreement between the parties but gives the VAT implications based on the nature of the transaction and the contractual capacity of the parties to the agreement.

2. Background

According to section 40 of the Constitution, the government of the Republic is constituted as national, provincial and local spheres of government, which are distinctive, interdependent, and interrelated. Schedules 4 and 5 to the Constitution set out the powers and functions allocated to each sphere of government. Under section 41(f) of the Constitution, all spheres of government and all organs of state within each sphere must not assume any power or function except those conferred on them under the Constitution.

The Constitution allows the national and provincial government to assign aspects of their legislative or executive powers or functions to a municipality, to move the operational responsibilities to a municipality under an agency agreement or to delegate functions to a municipality. Each method of contracting has VAT consequences that are set out in 4. In a VAT system, government is an end-user, and therefore any sphere of government should pay VAT on goods or services acquired by it.

2.1 Assignment

Under an assignment, a municipality takes over the function and there is a complete shifting of the responsibility either through legislation or by executive decision. An assignment can only take place once all the requirements or limitations in **2.1.1 to 2.1.3** of this BGR are met.

2.1.1 National assignment of functions (section 99 of the Constitution)

A Cabinet member may assign any power or function that is to be exercised in terms of an Act of Parliament to a member of a provincial Executive Council or to a Municipal Council. An assignment –

- a) must be in terms of an agreement between the relevant Cabinet member and the Executive Council member or Municipal Council;
- b) must be consistent with an Act of Parliament in terms of which the relevant power or function is exercised or performed; and
- c) takes effect upon proclamation by the President.

2.1.2 Provincial assignment of functions (section 126 of the Constitution)

A member of the Executive Council of a province may assign any power or function that is to be exercised or performed in terms of an Act of Parliament or a provincial Act, to a Municipal Council. An assignment –

- a) must be in terms of an agreement between the relevant Executive Council member and the Municipal Council;
- b) must be consistent with an Act in terms of which the relevant power or function is exercised or performed; and
- c) takes effect upon proclamation by the Premier.

2.1.3 Assignment of legislative authority (sections 44, 104 and 156 of the Constitution)

Section 43 of the Constitution provides that the legislative authority of the various spheres of government is vested as follows:

- a) The national sphere of government is vested in Parliament as set out in section 44 of the Constitution. The National Assembly may, under section 44(1)(a)(iii) of the Constitution, assign any of its legislative powers, except the power to amend the Constitution, to any legislative body in another sphere of government.
- b) The provincial sphere of government is vested in the provincial legislature as set out in section 104 of the Constitution. The provincial legislature may, under section 104(1)(c) of the Constitution assign any of its legislative powers to a Municipal Council in the province.

- c) The local sphere of government is vested in the Municipal Councils as set out in section 156 of the Constitution. A municipality has, under section 156(1)(b) of the Constitution, the executive authority and the right to administer any matter assigned to it by national or provincial legislation.

2.2 Old order legislation (Schedule 6 to the Constitution)

Transitional measure

Old order legislation, as outlined in Schedule 6 to the Constitution, serves as a transitional measure to ensure legal continuity and does not assign functions under the current constitutional framework.

Preservation of pre-existing laws until amended

The purpose of Schedule 6 is to preserve pre-existing laws at the time until they are repealed or amended by the new democratic legislature, not to create new assignments of power or function under the new Constitution.

Procedures for assigning functions

The Constitution provides explicit procedures for assigning functions requiring legislative or executive action, precluding the automatic assignment of functions through old order legislation under the new Constitution.

Constitutional supremacy

Any interpretation suggesting that old order legislation assigns functions would undermine the principle of constitutional supremacy by allowing old order legislation to override the explicit provisions and procedures established in the new constitutional order.

Interpretation of transitional provisions

Transitional provisions should be interpreted to support and enhance the new constitutional framework rather than create ambiguity or conflict with its core principles.

2.3 Supremacy of the Constitution (section 2 of the Constitution)

Section 2 of the Constitution provides that the Constitution is the supreme law of the Republic and that any law or conduct which is inconsistent with it is invalid.

It follows that any assignment of a national function or a provincial function that is inconsistent with the provisions of sections 99 or 126 of the Constitution, respectively, is invalid.

2.4 Agency and delegation (section 238 of the Constitution)

Under an agency arrangement or contract, a municipality performs the function on behalf of a national or provincial government. It therefore merely implements the national or provincial instructions and plans as per the agency agreement or service level agreement (SLA). It does not take on the authority or responsibility of having to perform that function as part of its constitutional mandate as envisaged in Schedules 4B and 5B to the Constitution.

A delegation takes place when national or provincial government authorises a municipality under an SLA to perform the function on its behalf. In this regard a municipality will be making a taxable supply of services to the national or provincial government in its capacity as a principal.

An executive organ of state in any sphere of government may, under section 238 of the Constitution –

- a) delegate any power or function that is to be exercised or performed in terms of legislation to any other executive organ of state provided the delegation is consistent with the legislation in terms of which the power is exercised or the function is performed; or
- b) exercise any power or perform any function for any other executive organ of state on an agency or delegation basis.

If a municipality is contracted by means of an agency agreement or an SLA to implement a national or provincial function on behalf of a national or provincial department, the provisions of section 54 as set out in **3.5** will apply. It follows that the municipality will be making a taxable supply of services to national or provincial government to the extent that the rendering of such service gives rise to the payment of an implementation fee, agency fee or management fee.

If a function of a national or provincial government is delegated to a municipality by means of an SLA, the municipality is contracted in its capacity as a principal. In this regard the municipality will be making a supply of goods or services to a national or provincial government in its capacity as a principal.

The instrument of an agency or a delegation may not be used to assign any of the national or provincial government functions to a municipality.

2.5 Importance of a contract or agreement entered into between a municipality and a national or provincial government

A contract or an agreement entered into by the parties to a transaction is an essential source document that is called for when establishing and considering the details of a transaction to determine the VAT consequences of the transaction. In this regard, national, provincial and local government must carefully consider the details of their contracts to ensure that their intentions are accurately reflected and that actions are aligned with intentions.

3. Discussion

Value-added tax is levied under section 7(1)(a) on the supply of goods or services by a vendor in the course or furtherance of an enterprise carried on by that vendor. This is subject to the exemptions, exceptions and adjustments provided for in the VAT Act.

3.1 Grants

The term “grant” is defined in section 1(1) and specifically excludes, amongst others, payments made by public authorities for the actual supply of goods or services to the public authority.

Section 8(5A) will apply only to the extent that no actual supply of goods or services are made to national or provincial government in return for the payment received by a municipality.

3.2 Section 8(5A)

A vendor (excluding a designated entity) that receives a “grant” from a public authority in the course or furtherance of an enterprise carried on by the vendor is deemed to supply a service to the relevant public authority under section 8(5A).

3.3 Zero rate

A service that is deemed to be supplied under section 8(5A) is subject to VAT at the rate of 0% under section 11(2)(f).

3.4 Input tax

Value-added tax paid on goods or services acquired by a vendor may be deducted by the vendor to the extent that such VAT constitutes “input tax” as defined in section 1(1). The definition of “input tax” determines that, amongst others, the goods or services must be acquired by a vendor for consumption, use or supply in the course of making taxable supplies. The deduction is subject to sections 16(2) and (3), 17, and 20. Furthermore, the vendor’s deduction is limited to the five-year period contemplated in the proviso to section 16(3).

3.5 Agent (section 54)

The VAT Act does not define the term “agent”. In this regard the term “agent” will take its ordinary dictionary meaning, as applied to the subject matter with regard to which it is used.

Under section 54(1), if an agent acts on behalf of a principal in supplying goods or services, the supply is deemed to be made by the principal and not the agent for VAT purposes. To the extent that the supply made by an agent on behalf of the principal is not a taxable supply, the agent may not issue a tax invoice in respect of such supply.

Similarly, if any vendor makes a taxable supply of goods or services to an agent who is acting on behalf of a principal, the supply is deemed to be made to the principal and not the agent under section 54(2). This is the case even if the supplier may have issued the tax invoice in the name of the principal.

The effect of section 54(1) and (2) is that an agent may not account for output tax or deduct input tax on supplies of goods or services made or acquired by the agent on behalf of a principal.

The agent must, under section 54(3), notify the principal in writing within the prescribed 21-day period of the requisite particulars of the supply that was made or received on behalf of the principal.

Under the VAT Act, for an arrangement to qualify as that of agency, the agent may not make a margin on supplies made or received on behalf of a principal unless the agreement explicitly makes provision for this.

4. Ruling

This ruling, in table form below, sets out the VAT consequences applicable to each method of contracting in the form of assignment (of powers of functions and legislative authority), agency and delegation.

VAT consequences of functions assigned to or performed by a municipality under an agency or delegation basis		
Assignment of powers or functions and legislative authority	Agency (May not be used to assign powers or functions)	Delegation (May not be used to assign powers or functions)
<p>a) Grant received in the course or furtherance of carrying on an enterprise:</p> <ul style="list-style-type: none"> i) A taxable supply is deemed to be made by the municipality under section 8(5A). ii) The taxable supply is zero-rated under section 11(2)(t). iii) The municipality must issue zero-rated tax invoice under section 20. iv) The municipality must account for the zero-rated supply. v) The municipality may deduct input tax on the VAT incurred on goods or services acquired in the course or furtherance of carrying out the assigned function subject to section 1(1) definition of "input tax" and sections 16(2), 17, and 20. 	<p>d) The municipality is contracted to perform a function on an agency basis. The agency fee, management fee or implementation fee is consideration for a standard-rated supply of services.</p> <ul style="list-style-type: none"> i) The municipality must account for output tax on the full price of the agency, management or implementation services. ii) The municipality must issue a standard-rated tax invoice under section 20 in respect of the agency services supplied to national or provincial government. iii) The municipality is entitled to deduct input tax on the VAT incurred on goods or services acquired in the making of the taxable supply of agency, management or implementation services. 	<p>e) The municipality is contracted in its capacity as a principal to perform a delegated function. It supplies services to national or provincial government in its capacity as a principal (contractual principal) and charges VAT on these supplies.</p> <ul style="list-style-type: none"> i) The full contract price is the consideration for a taxable supply of goods or services. ii) The taxable supply is subject to VAT at the standard rate under section 7(1)(a). iii) The municipality must issue a standard rated tax invoice under section 20. iv) The municipality must account for output tax calculated on the full price of the contract.

Assignment of powers or functions and legislative authority	Agency (May not be used to assign powers or functions)	Delegation (May not be used to assign powers or functions)
<p>b) Grant received in the course of carrying on non-enterprise activities:</p> <ul style="list-style-type: none"> i) The grant is received outside the scope of the VAT Act. ii) No output tax liability arises for the municipality on the receipt of such a grant. iii) The municipality is not entitled to deduct any input tax on goods or services acquired in the course or furtherance of carrying out the assigned function. <p>c) Old order legislation assignments which are inconsistent with the national or provincial assignment of functions as contemplated in section 99 or 126 of the Constitution are invalid. The effect of this is that the VAT consequences set out in a) and b) of this table will not apply to such old order legislation assignments.</p>	<p>This is subject to section 1(1) definition of “input tax” and sections 16(2), 17, and 20. This would be limited to overheads and direct costs relating to the management or contractual agency services.</p> <p>iv) The municipality is not entitled to deduct input tax on the VAT incurred on goods or services acquired to perform the function on behalf of province, as the supply of goods or services in question is deemed to be made to the province and not to the municipality under section 54(2). This is applicable even if the contract may be in the name of the municipality. The municipality must issue a statement under section 54(3) to provincial government setting out the goods or services acquired on behalf of provincial government.</p>	<p>v) The municipality is entitled to deduct the full VAT incurred on goods or services acquired in performing the delegated function subject to section 1(1) definition of “input tax” and sections 16(2), 17 and 20.</p>

Assignment of powers or functions and legislative authority	Agency (May not be used to assign powers or functions)	Delegation (May not be used to assign powers or functions)
	<p>Failure to meet this requirement will result in the transaction being treated as a taxable supply made by the contractual principal and therefore the full contract price will be subject to VAT.</p> <p>v) Output tax is calculated based on the amount retained by the municipality and not to the full amount expended by the municipality in the course of performing the function on behalf of a national or provincial government provided the above conditions are met.</p>	

This ruling constitutes a BGR issued under section 89 of the Tax Administration Act 28 of 2011.

5. Period for which this ruling is valid

This BGR applies from date of issue, and is valid until it is withdrawn, amended or the relevant legislation is amended.

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