VAT NEWS

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LAW AMENDMENTS

In this issue, we focus on recent amendments on the VAT treatment of **public authorities and public entities**, contained in The Revenue Laws Amendment Act, 2004 **(Act No. 32 of 2004)**. The VAT implications of **grants** made by these entities as well as changes with regard to the **Skills Development Levy (SDL)** are also included. The amendments were promulgated on 24 January 2005 in Government Gazette No. 27188. However, the changes dealt with in this issue will only come into effect from a future date ("the effective date") to be announced by the President in the Government Gazette.

For more information on these, and other amendments contained in the Second Revenue Laws Amendment Act, 2004 **(Act No. 34 of 2004)**, visit the SARS website *www.sars.gov.za/legislation/.*

DEFINITION OF "PUBLIC AUTHORITY"

National and provincial public entities listed in Parts A and C of Schedule 3 to the Public Finance Management Act, 1999 ("the PFMA") carry on activities which are either similar to those carried out by a government department and/or they are funded mainly by Government. These public entities (hereafter referred to as "3A and 3C public entities") are therefore included in the definition of "public authority" so that they are treated the same for VAT purposes as other **national and provincial government departments** which are listed in Schedules 1, 2 and 3 of the Public Service Act, 1994.

The definition also includes:

- any subsidiary or entity under the ownership control of 3A and 3C public entities;
- public entities in transition, such as those not yet classified, or which are in the process of being re-classified as a 3A or 3C public entity; and
- any component of a government department, for example, a local or regional branch office, a division of the department or a separate trading account.

DEFINITION OF "ENTERPRISE"

Government departments are generally not liable to register for VAT, unless they are specifically notified by the Minister of Finance ("the Minister") to do so. This means that, as final consumers, the VAT incurred on capital and operating expenses is regarded as a cost. This treatment is now extended to include the activities of 3A and 3C public entities. Any public authority which has been notified by the Minister to register for VAT is known as a "designated entity". (See *DEFINITION OF "DESIGNATED ENTITY"*).

DEFINITION OF "DESIGNATED ENTITY"

"Designated entity" is a new definition which includes the following vendors:

- Public authorities (including 3A and 3C public entities) which have been notified to register;
- Major public entities listed in Schedule 2 of the PFMA;
- National or provincial government business enterprises listed in Parts B or D of Schedule 3 to the PFMA;
- Public Private Partnerships (PPP's) as contemplated in the PFMA and the Treasury Regulations; and
- Welfare organisations.

Designated entities essentially carry out work which would otherwise be done by government, but compete with other vendors in the economy. The funding that these entities receive is treated on the same basis as the consideration received by other vendors for making the same or similar taxable supplies. Payments to designated entities are therefore taxable at the standard rate of 14% (unless the deemed supply is by a welfare organisation, in which case the zero rate applies).

CONSTITUTIONAL INSTITUTIONS

Constitutional Institutions listed in Schedule 1 to the PFMA do not fall within the new definition of "public authority". However, these entities may not register for VAT as their activities are excluded altogether from the definition of "enterprise". (See proviso (viii) to the definition of "enterprise").

Constitutional Institutions which were on the VAT register prior to the effective date will qualify for the relief provided in terms of proviso (iv) to section 8(2) of the Act as described under *"DEREGISTRATION OF PUBLIC AUTHORITIES"*.

SECTORAL EDUCATION TRAINING AUTHORITIES (SETA's) AND SKILLS DEVELOPMENT LEVY (SDL)

The effect of the amendments with regard to SDL and SETA payments is that from the effective date:

- SETA's will be required to deregister for VAT as discussed under *"DEREGISTRATION OF PUBLIC AUTHORITIES"*. Any payments they receive from Government will therefore not include VAT;
- SETA grants will be zero-rated in the hands of the vendor receiving the payment in terms of section 8(5A) and 11(2)(t); and
- **Vendors will no longer be allowed to claim input tax on any SDL payments made.**

This will simplify the administration and accounting for SDL and SETA payments.

The relief provided in terms of proviso (iv) to section 8(2) of the VAT Act as described under *"DEREGISTRATION OF PUBLIC AUTHORITIES"* includes the value of the balance of undistributed SETA grant funds.

ENTITIES NOT YET LISTED IN THE PFMA

Transitional rules will apply to those entities which are in the process of being classified (or re-classified) in terms of the PFMA as at the effective date. The VAT treatment of these entities will be decided upon by National Treasury in consultation with SARS, based upon the circumstances of the particular case and/or similar cases encountered.

REGISTRATION OF PUBLIC AUTHORITIES

Some public authorities carry on commercial activities which may be in competition with the private sector, in addition to their core regulatory or statutory activities. Where this happens, those activities must be conducted under a separate legal entity which is appropriately classified in terms of the PFMA. The framework for determining if the activity is a "significant" enterprise activity in respect of which that entity must register, will be determined jointly by SARS and the National Treasury.

Public entities which are not on the VAT register, but which will be liable for VAT on or after the effective date will not be able to claim an input tax adjustment in terms of section 18(4) of the Act on the assets used in the enterprise.

Example

From the effective date, a 3A public entity is not liable to register for VAT as it is regarded as a "public authority". However, if the entity was re-classified as a National Government Business Enterprise (listed in Part B to Schedule 3 to the PFMA), the normal test for an "enterprise" in terms of paragraph (a) of the definition of that term applies from the date of re-classification. If the entity must register for VAT, it will not be entitled to claim an input tax adjustment on the assets applied for enterprise purposes.

Any applications for registration in this regard must be forwarded to SARS Head Office, VAT Law Administration section, Private Bag X923, Pretoria, 0001, facsimile number (012) 4225194. After considering the merits of the case, that entity will be notified accordingly.

DEREGISTRATION OF PUBLIC AUTHORITIES

From the effective date, some entities which are now on the VAT register will fall within the amended definition of "public authority" and will have to deregister for VAT, unless they are notified to the contrary by the Minister. For example, this will affect many of the 3A and 3C public entities.

However, the public authority concerned will not be required to pay output tax on the value of their assets upon deregistration, as relief in this regard has been provided for under proviso (iv) to section 8(2) of the VAT Act.

The relief does not apply to those entities which registered for VAT between 22 December 2003 and 31 March 2005.

GRANTS

The term "grant" replaces the term "transfer payment" in the VAT Act. Disbursements made from public funds either directly to vendors by National Treasury, or via the budget vote of another public authority will be zero-rated in the hands of the recipient.

Grants to vendors are also distributed via the budgets of local authorities. To ensure that these grants are treated on the same basis as grants from public authorities, sections 8(5A) and 11(2)(t) were introduced to zero-rate the deemed supply which arises in this regard. Similarly, housing subsidy payments made in terms of the Housing Act, 1997 are zero-rated in terms of sections 8(23) and 11(2)(s) of the Act.

To qualify as a grant, the payment must not be in respect of the supply of goods by the recipient to that public authority in terms of the prescribed procurement procedures applied by public and local authorities. The term "procurement" normally refers to supplies paid for under the budget headings *"Current payments"* or *"Payments for capital assets"*.

However, it should be noted that this "procurement test" is not the only manner in which a payment may be excluded from qualifying as a "grant". Where the payment appears to be a "grant", but is in fact consideration for a supply which falls outside of the normal procurement procedures or budget headings applied by that public or local authority, the supply must attract VAT in accordance with the normal VAT rules.

Examples

- Payment for office supplies paid out of petty cash which fall below a certain threshold value and outside of the formal procurement process;
- Funds paid to a vendor in terms of a "grant contract" under the budget item headed *"Transfers and subsidies to:"*, but where part of the funds must be used to purchase assets which become the property of the grantor;
- A "grant" with such onerous conditions attached, that the recipient can rightly be regarded as supplying a service to the grantor in return for the payment.

CONTACTING SARS: Where vendors have queries relating to VAT, including where to fax their returns, they should contact their local SARS branch office. Additional information can be obtained on the SARS website at: www.sars.gov.za