Republic of South Africa

IN THE TAX COURT

HELD IN CAPE TOWN

Coram: LE GRANGE, J (President of the Tax Court)

Assessor 1: MR B.R HILLIARD (SAICA Representative)

Assessor 2: MR T.M PASIWE (Commercial Representative)

CASE NO: VAT 969

In the matter between:

ABD CC **Appellant**

And

THE COMMISSIONER FOR

THE SOUTH AFRICAN REVENUE SERVICE **Respondent**

JUDGMENT DELIVERED – 30 MARCH 2015

LE GRANGE, J:

[1] This appeal is essentially concerned with the meaning and application of the zero rating provisions of section 11(2)(l) of the Value-Added Tax Act, No 89 of 1991("the Act"). The principle that the Value-Added Tax ("VAT") system in

South Africa is a destination based tax that imposes tax on goods or services consumed in the Country regardless of where the goods were produced or services supplied is now well established. In this regard see MASTER CURRENCY v CSARS (PTY) LTD 2014 (6) SA 66 (SCA) at 74 A. The difficulty, as in the present instance, arises, however, where goods and services are contractually supplied to a person who is outside the Republic, but physically rendered to a person who is in the Republic at the time the services are rendered for the benefit of both the person outside the Republic and the person inside the Republic. In such circumstances, is VAT applied at zero rate or at the standard rate of 14%?

[2] ABD CC ("the Appellant") is a registered VAT vendor in terms of the Act and operates a business involving the supply of services to Foreign Tour Operators ("FTOs"). The Appellant normally enter into agreements with FTOs to arrange tours in South Africa for the FTOs' customers ("the Customers"). The FTO and the Customer are non- residents of South Africa. The tour packages will, amongst others, include hotel accommodation, restaurants, guided tours and excursions ("the local services"). The Appellant, in arranging the tours, enters into agreements with local service providers in terms of which the local service provider agrees to supply the local service to the Customers when they undertake the tours in the Republic. At the time when the Appellant enters into the agreements with the FTOs and arranges the local services, neither the FTOs nor the Customers are in the Republic. However, when the local services are

rendered the Customers are in the Republic. The Appellant will invoice the FTOs for a lump sum, including the local service provider's costs and a mark-up. The local service providers will invoice the Appellant for the local services and the Appellant pays these invoices.

[3] The Respondent ("the Commissioner") has assessed the Appellant for VAT which included penalties and interest. The periods in question are for end of February 2008, February 2009 and April 2010. The cumulative amounts in question are as follows: VAT, R10 996 386.00; Penalties, R1 099 639.00; and Interest in the amount of R2 199 793.00. The basis for the assessment is underpinned by the Commissioner's view that the Appellant rendered local services to the Customers of the FTOs, at the time they were in the Republic, and as such the services rendered are not part of the zero-rating provisions of section 11(2)(l).

[4] The Appellant lodged an objection to the Assessments. The Commissioner upheld the objection to the penalties, but disallowed the objection to the VAT and interest. The Appellant thereafter lodged an appeal against the disallowance of its objection.

[5] The principal objection against the assessment according to the Appellant is that the Commissioner incorrectly approached and applied the zero rating

provisions of s 11(2)(l) of the Act as no services were directly rendered by the Appellant to the FTOs' Customers when the Customers were in the Republic .

[6] The Amended Statement of Grounds of Assessment, read with the Amended Statement of Grounds of Appeal, records largely the common cause facts and those that are in dispute. It was further agreed by the parties that even though documents of only five tours have been selected for the purpose of this appeal, the ultimate ruling of this Court will apply to all tours relevant to the assessment period. The documents of the five tours selected (Bundles A-D) included the following: documents in relation to X Entity in France, in respect of the Y Group that toured the Republic between March and April 2010; documents of the tour arranged for Z Entity in Greece, in respect of the LM Group that toured the Republic in February 2010; documents in respect of the tour arranged for DKY in respect of the K Group that toured the Republic in January 2010; documents of the tour arranged for QR in respect of the Q Group that toured the Republic in February and March 2010; and documents for the tour arranged for T Tours in respect of a family named TT that toured the Republic in February-March 2010.

[7] The Appellant was the only party who elected to call witnesses. Mr S, one of the founding members of the Appellant, Ms M, an employee and manager of

the inbound section at the Appellant, and Ms R, also an employee of the Appellant, dealing with incentives and corporate clients, testified.

[8] The evidence of the witnesses in relation to the details of the corporate and leisure tours is largely consistent with the information contained in the tour Bundles A - D. The documents in question show the Appellant contracted with local suppliers to provide the local services to the Appellant. The Appellant in turn supplied the local services to the FTOs as listed in the itineraries, budgets and or programmes. The local services, amongst others, included accommodation, meals, tours, transport, conference facilities and entertainment.

[9] According to Mr S, written contracts were not always concluded between the Appellant and the relevant FTOs. In respect of the tour arranged for X Entity, a written agreement was concluded. According to the agreement the Appellant provided the materials and services and X Entity agreed to purchase such from the Appellant. Mr S further testified that the basis of the contractual relationship between the Appellant and certain of the FTOs regarding leisure tours was that the Appellant was providing the local services listed in the itinerary, budget and or programme and that the FTOs were purchasing such services. He further testified that if an agreement was concluded between the Appellant and a FTO, a deposit of 30% was required from the FTO to ensure that certain essentials in terms of the agreement were paid. The second payment, to be made before the arrival of the tour group in South Africa, would than cover approximately 90-95% of the costs. According to Mr S the last 10% is the Appellant's profit and gets

paid after the tour is completed.

[10] In cross-examination Mr S conceded that consultants of the Appellant were involved in ensuring the local services were properly provided during the tours. Such consultants would, for instance, be at the hotel, to make sure that conference facilities were correctly set up, for instance by checking microphones, and white boards, amongst others. Mr S further testified when there is a complaint about a local service which was supplied to a Customer the FTOs would demand, on behalf of the customer, that the Appellant rectify the problem. This apparently did happen when there was a complaint by a particular customer about a shortage of water at a Hotel. The FTO contacted the Appellant to rectify the problem. The contract between the Appellant and a local hotel, V Hotel, was also highlighted. According to the contract the Appellant is recorded as the "Tour Operator" who is in the business of selling hotel rooms to third parties. According to the contract, V Hotel, 'the Hotel', granted the Appellant, the "Tour Operator", the right to sell rooms and further acknowledged the Appellant will act on its own behalf when selling the rooms to third parties. Mr S conceded that if the V Hotel did not fulfil its obligation in providing a room to a Customer then neither the Customer nor the FTO could directly approach the Hotel. Rather, the FTO had to look to the Appellant to rectify the problem. Mr S was adamant that although the Appellant entered into agreements with the local suppliers, for the supply of services to the Appellant, as in the instance of V Hotel, the Appellant never directly provided these local services to the FTOs or

its Customers when in the Republic.

[11] Ms M in her evidence essentially confirmed the working system of the Appellant in arranging tour packages for FTOs. She also testified how certain mark-ups were effected by the Appellant. According to her the Appellant would enter into agreements with local suppliers for services to be supplied to the Appellant. The suppliers would invoice the Appellant for payment. The Appellant, having ascertained the prices to be charged by the local suppliers, would ultimately quote and invoice the FTOs for a lump sum figure, made up of the prices quoted by the local suppliers and the Appellant's mark up. In cross-examination Ms M conceded that the FTOs were not advised of and had no knowledge of the prices charged by the local suppliers. According to her the amounts charged by the Appellant to the FTOs were determined by the market as the FTOs were buying a service from the Appellant. Ms M further confirmed that in certain instances employees of the Appellant do check-ups at hotels and conference venues to see if certain services were provided as agreed with the FTO.

[12] The evidence of Ms R was unchallenged. Her testimony essentially centred on her involvement in preparing documents and e-mails in respect of the tour arranged for X Entity.

[13] The Appellant in its Amended Grounds of appeal raised, inter alia the following grounds of appeal:

"6.4 The services which are the subject of this dispute are not supplied directly by the Appellant to the foreign tourists who purchase the tour packages from such tour operators;

6.5 The only services which are the subject of this dispute which are directly supplied by the Appellant are those originally supplied to the tour operators at a time when the foreign tour operators are not in the Republic;

6.6 The Appellant does not undertake to render or render any of the actual services involved in the tours (defined in the grounds of assessment as the "Local Services") – those are provided by the parties who are responsible for supplying the arranged accommodation, food, transportation, excursions, etc that form part of the tour packages;

6.7 The reference in section 11(2)(l)(iii) of the VAT Act to services supplied directly "to the said person or any other person" if such person(s) are in the Republic at the time the services are rendered means that the "services rendered" refers back to the services supplied directly by the Appellant. This can only relate to the Appellant's services to the tour operators in pre-arranging the package tours and cannot be referring to the services rendered to tour operators or tourists by third parties, which are not the services that have been directly supplied by the Appellant to the tour operators. In other words, because the services of arranging the tour packages are not services supplied directly to the tour operators or their customers in the circumstances where the services

provided by the Appellant are rendered to such persons while they are in the Republic, the exclusion from zero-rating cannot apply;

6.8 An example of a direct supply of services that would be excluded from zero-rating in terms of section 11(2)(l)(iii) would be where a hotel sells block bookings of rooms to the overseas tour operator, and thereafter itself renders the service of providing such hotel accommodation to the tour operator or its customers while they are in South Africa;

6.9 The exclusion from zero-rating provided for in section 11(2)(l)(iii) is consequently inapplicable."

[14] The Commissioner in its Amended Statement of Grounds of Assessment relies, inter alia, on the following legal grounds:

> **"***17 <u>Legal grounds upon which SARS relies</u>*
>
> *17.1 The supply of the Local Services by the Appellant was a supply of services by the Appellant in the course or furtherance of an enterprise carried on by it, as contemplated in subsection 7(1)(a) of the Act.*
>
> *17.2 Accordingly, VAT at the rate of 14 per cent was levied on such supplies in terms of subsection 7(1).*
>
> *17.3 The provisions of subsection 11(2)(l) did not apply to the supply of the services by the Appellant for the following reasons:*

17.3.1 in order for the provisions of subsection 11(2)(l) to apply, such services must not be "services which are supplied directly … to … any person … if … such … person is in the Republic at the time the services are rendered";

17.3.2 such services were "supplied directly" by the Appellant to the Customers;

17.3.3 the Customers were "in the Republic at the time the services [were] rendered"."

[15] Mr M Seligson SC assisted by Mr M Janisch appeared for the Appellant. Mr P Solomon SC assisted by Ms E Boltar appeared for the Commissioner.

[16] It was argued on behalf of the Appellant that on a proper consideration of the facts the overwhelming body of evidence in this matter clearly demonstrates the Appellant did not provide the local services to the customers. Moreover, the tenor of the written agreements and various e-mail correspondences between the consultants of the Appellant and the FTOs convincingly establishes that the Appellant did not enter into any dealings with the Customers directly. According to Mr. Seligson the services which the Appellant rendered were not subject to VAT at the standard rate in terms of s 7(1) of the Act but fall squarely within the zero rating provisions of s 11(2)(l)

[17] Counsel for the Commissioner contended that the Appellant completely misconstrued the relevant zero rating provisions in s 11(2)(l) and the facts upon which the Commissioner is relying. According to Mr. Solomon the evidence clearly established that the Appellant, in the course or furtherance of its enterprise, in order to fulfill its contractual obligations to the FTOs, indeed supplied the local services to the Customers, and when those services were rendered, the Customers were in fact in the Republic. It was further argued that if regard is had to the Appellant's involvement in the tours, the contracts it concluded with local suppliers, the correspondence, the invoicing method of the appellant and its financial accounts then it is overwhelmingly clear the Appellant did not simply provide the services of arranging local services on behalf of the FTOs, but indeed supplied the local services to the Customers when they were in the Republic. According to Mr. Solomon on a proper reading of the general scheme of the Act and the Explanatory Memoranda that accompanied the relevant amendments to s 11(2)(l), it is clear that the local services consumed by the Customers at the time they were in the Republic attract VAT at the standard rate.

[18] Section 11(2)(l) of the Act defines services to non-residents, which are zero rated. The relevant provision provides, as follows: *"Where, but for this section, a supply of services would be charged with tax at the rate referred to in section 7(1), such supply of services shall, subject to compliance with*

subsection (3) of this section, be charged with tax at the rate of zero per cent where-

…

(l) the services are supplied to a person who is not a resident of the Republic, not being services which are supplied directly-

(i) …; or

(ii) …; or

(iii) to the said person or any other person, …, if the said person or such other person is in the Republic at the time the services are rendered, …"

[19] Section 7(1)(*a*) provides as follows:

"Subject to the exemptions, exceptions, deductions and adjustments provided for in this Act, there shall be levied and paid for the benefit of the National Revenue Fund a tax, to be known as the value-added tax – (a) on the supply by any vendor of goods or services supplied by him on or after the commencement date in the course or furtherance of any enterprise carried on by him … calculated at the rate of 14 per cent on the value of the supply concerned …"

[20] The present appeal involves only services and "*services*" are defined in section 1 of the VAT Act as:

> *"anything done or to be done, including the granting, assignment, cession or surrender of any right or the making available of any facility or advantage, but excluding a supply of goods, money or any stamp, form or card contemplated in paragraph (c) of the definition of 'goods'".*

[21] Section 9(1) deals with the time of supply, and reads as follows:

> *"For the purposes of this Act a supply of goods or services shall, except as otherwise provided in this Act, be deemed to take place at the time an invoice is issued by the supplier or the recipient in respect of that supply or the time any payment of consideration is received by the supplier in respect of that supply, whichever time is earlier."*

[22] In the recent decision of MASTER CURRENCY V CSARS *supra* the Supreme Court of Appeal referred to the language and construction of s 11(2)(l), the various amendments from time to time and the explanatory memoranda that accompanied such amendments. The dictum at page 74 in paragraph [17], where the following was held, is in my view instructive:

> *"[17] Subparagraph (ii)(aa) does not require the recipient to be in the Republic when the services are rendered. This reflects the principle that services consumed in the Republic attract VAT at the standard rate. The*

historical amendments to s 11(2)(l) demonstrate this principle. Originally, s 11 (2)(l) provided that services were zero-rated if supplied 'for and to a person who is not a resident… and who is outside the Republic … at the time the services are rendered'. The amendments brought about by s 89 of the Taxation Laws Amendment Act 30 of 1998 deleted the italicized words in s 11(2) and introduced para (l) (iii) as a self-standing exception. Further amendments to s 11(2) and specifically s 11(2)(l) were made by the Taxation Laws Amendment Act 27 of 1997, followed by the amendments made by the Taxation Laws Amendment Act 30 of 1998 and the Revenue Laws Amendment Act 53 of 1999. The Explanatory Memorandum on the 1998 Taxation Laws Amendment Bill stated (clause 89):

'When VAT was introduced, the intention was to levy VAT on consumption in the Republic. To achieve this, those supplies where consumption does not take place in the Republic and the benefit of services is not enjoyed in the Republic, are subjected to VAT at a rate of zero percent …

The amendment to section 11(2)(l) is aimed at eliminating any doubt as to the scope of this subsection. The supply of the services must be made to a recipient who is not a resident, and neither the recipient nor any other person to whom the services are rendered may be in the Republic at the time the services are rendered, for the zero rate for VAT to apply.'

The Explanatory Memorandum in respect of the 1999 amendment stated (clause 85):

'This amendment is aimed at putting it beyond doubt that the presence in the Republic of the recipient of a service, or of any other person to whom the service is rendered, at the time the service is physically rendered… will prohibit the zero-rating provided for in this subsection from being applied.'

[23] In my view it follows that in terms of s 11(2)(l), the supply of a service to a non-resident excludes the zero rating provisions if a recipient of such a service or any other person to whom the service is rendered is in the Republic at the time the service is actually rendered. There can be no doubt that the Legislature, by inserting the words "at the time the services are rendered", rather than the usual reference to a "supply of services", in paragraph (iii) of subsection 11(2)(l) intended that the zero rated provisions would not apply if the recipient was in the Republic at the time the services were actually supplied, even though such recipient was not in the Republic when the services were deemed to have been supplied as provided for in terms of s 9(1) of the Act. *(The general rule relating to time of supply is that the supply is deemed to have taken place where an invoice is issued or any payment in respect of the supply is received, whichever is earlier except as otherwise provided for in the Act.)*

[24] In the present instance, to determine whether the services the Appellant provided to the FTOs, and ultimately to its Customers, fall into the zero rating provisions, regard must be had to the historical amendments to s 11(2)(l) and the principle that VAT is essentially a tax on the consideration given for the supply of goods or services which are consumed in the Republic. Moreover, it is important to identify the services the Appellant rendered, and when such services were rendered, and to establish whether, at the time the services were actually rendered, a recipient of the services or any other person to whom the service was rendered was in the Republic.

[25] The Appellant contended that its services should be zero rated by virtue of the fact that it did not supply or render any services *"directly"* to the FTO's Customers. Counsel for the Appellant contended that the requirement that the services be *"supplied directly"* indicates that there must be a direct connection between the party that supplies the services and the recipient thereof. To this extent the argument advanced was that the Appellant purchases the local services and on-sells them, or acquires the right to have the local services performed and cedes or passes on this right to the FTO. According to the Appellant, in each case it supplies its services or facilities only to the FTO and it is the FTO that then makes these services or facilities available to its Customers.

[26] Counsel for the Commissioner argued that if one considers the reasons given for the introduction of Paragraph (iii), in the Explanatory Memorandum the retention of the word *"directly"* in the subsection was not intended to give a new meaning to the concept of a supply of services. According to Counsel it was simply there for historic reasons.

[27] In my view, the answer must be found in the Explanatory Memorandum as discussed in Master Currency *supra* at 74F, where the following was recorded:

> *'This amendment is aimed at putting it beyond doubt that the presence in the Republic of the recipient of a service, or of any other person to whom the service is rendered, at the time the service is physically rendered… will prohibit the zero-rating provided for in this subsection from being applied.'*

[28] It is not in dispute that at all relevant times the FTOs and the Customers were non -residents of the Republic as contemplated in s 11(2)(l). It is further common cause the services the Appellant supplied consisted of those listed in the budgets and or programmes that form part of the tour packages that were sold to the FTOs. The relevant services, amongst others, included accommodation, meals, transport, conference facilities, entertainment and tours. The evidence of the witnesses and documentary evidence prove the Appellant contracted with the local service providers. Some of the contracts entered into

between the local suppliers and the Appellant expressly state that the local services were provided to the Appellant.

[29] In this regard the contract between the Appellant and the V Hotel (see Bundle F-174ff) is of relevance. The contract records *inter alia* that the Appellant is the "*Tour Operator*" and "*is in the business of selling hotel rooms to third parties*" and that V Hotel "*hereby grants the Tour Operator the right to sell rooms"*. In terms of the contract (clauses 3 and 7) it was further recorded that the Appellant will not sell rooms to end users or third parties at a rate lower than the Hotel's retail rate and that the Appellant will act in its own name when selling the rooms to end users or third parties. The Appellant in turn supplied the rooms to the FTOs or to the FTOs' Customers on their behalf.

[30] In this instance, the overwhelming evidence does not support the contention of the Appellant that it was merely acting as an agent or intermediary to arrange a room on behalf of the FTOs. The evidence rather favours the Commissioner's view that the Appellant was indeed in the business of providing or 'selling' Hotel rooms directly in its own name to end users and or third parties in the course or furtherance of its enterprise as contemplated in s 7(1)(a) of the Act. In fact, Mr S admitted during cross-examination that if V Hotel did not fulfil its obligation in providing a room to a Customer, that recipient or Customer or

the FTO could not directly approach the Hotel to complain but had to look to the Appellant to rectify the problem.

[31] The contention by the Appellant that it did not own the Hotel or its rooms and therefore could not have provided the Hotel rooms directly to the FTO's Customers is in my view fictional and cannot be accepted as correct. An obvious example is that of a lessee of premises who is not the owner but can sub-let the premises. There can be no doubt that in such instances the person who supplies the accommodation service to the sub-lessee is the main lessee and not the owner.

[32] It was also contended by the Appellant that at the time the agreements with the FTO's were entered into and the local services were arranged, neither the FTO nor the Customer was in the Republic and therefore the zero rating provisions must apply. The general rule relating to time of supply is that supply is deemed to have taken place when an invoice is issued or any payment in respect of the supply is received, whichever is earlier, except as otherwise provided for in the Act (my underlining). See s 9(1) of the Act.

[33] According to the provisions of s 11(2)(l), the zero-rating provided for in the subsection will not apply if the recipient of a service, or any other person to whom the service is rendered, at the time the service is physically rendered is

present in the Republic. The Explanatory Memorandum (clause 85) of the 1999 amendment provides ample guidance on what the intention of the Legislature was regarding the presence in the Republic of a recipient of a service or any other person to whom the service is rendered.

[34] In this instance the service could only have been rendered when the Hotel rooms were actually made available to the Customer(s) at the time the Customer was in the Republic. It follows that the Commissioner's view that the rendering of services of the hotel rooms by the Appellant excludes the zero rating provisions of the subsection cannot be faulted as the Appellant supplied the services to the FTO (which was never in the Republic) but the services was actually rendered to the Customer (who was in the Republic at the relevant time). In my view s 11(2)(l)(iii) seems specifically to envisage a situation where the service is supplied (i.e. contractually) to X but is physically supplied (i.e. rendered) to Y.

[35] The Appellant's further contention that it only provided pre-arranged tour packages as an agent or intermediary for the FTO does not bear scrutiny. In this regard, the contract between the Appellant and X Entity (Bundle A at p46) is of relevance. The contract records *inter alia* that the Appellant "*ABD CC will provide and X ENTITY will purchase materials and services for the programme..*" (the programme consists of the local services).

[36] There were also no contracts concluded, in respect of the relevant local services, between the suppliers of the local services and the Customers or FTOs whereby the local suppliers would provide the services to the FTO or Customer. In fact, some of the contracts entered into between the Appellant and the local suppliers expressly state that the local services were being provided to the Appellant.

[37] The Appellant's consultants were also involved in ensuring that the local services were properly provided during the tours. Mr S in cross-examination conceded that the consultants would, for instance, be at the hotel, making sure that conference facilities were correctly set up, checking microphones and white boards, amongst others. He further testified that the Appellant is being paid to provide those services. Tour guides employed by the Appellant were also involved in supervising some of the local services provided which included activities such as car rallies.

[38] Moreover, the local services the Appellant listed in the relevant budget were described by the Appellant as "our services" and the total amount stated in the budget was described by the Appellant as being "total services". The invoices which the Appellant issued to the FTOs were for the provision by the Appellant of the local services. The invoices were each for a percentage of a specified budget

or for the final services as per an identified budget. Furthermore, the amounts charged by the Appellant to the FTO were determined based on what the FTO was willing to pay for the local services. The Appellant had set its own mark-up in respect of the local services that could vary from 0%-100%. In fact, Ms M admitted in her evidence that the Appellant's mark-up was not a concern for the FTO because they were buying a service from the Appellant. This method of invoicing hardly suggests that the Appellant is simply pre-arranging tour packages as an agent or intermediary.

[39] Furthermore, the Appellant in its annual financial statements included the value of the services supplied by it to the FTOs in its gross revenue. These amounts were the full amounts for which the Appellant invoiced the FTOs, and the goods and services supplied by the Appellant included the goods and services reflected in the relevant budget and or programme. The Appellant included in its cost of sales and claimed as expenses the amounts which were invoiced to it by the local suppliers. This means the Appellant in its accounts took the view that it was acquiring services from the local service providers, which constituted its cost of sales, and it included in its income amounts which it charged for rendering those services. This view was also confirmed by Mr S in cross-examination. In the budgets and or programmes no fees were also reflected as income for the arranging or pre-arranging of tours charged to the FTO's.

[40] Generally, the Appellant only made a profit after the successful completion of the tours. In addition to the profit comprising it's mark-up, the Appellant made a further profit, that is generally equivalent to 14% of the charges of the local suppliers, as the Appellant would claim an input deduction in the circumstances but not charge output VAT (on the view, erroneous in my opinion, that its services were zero rated). In the final budget sent to X Entity an amount of R940 737 was showed as a "total for services" in the Republic that had to be paid by the FTO. The amount comprised the lump sum total charged by the Appellant to X Entity for the costs of the local supplies plus its mark-up. The inescapable conclusion is that in this instance the Appellant did not act as an agent or intermediary when it provided the tour package to the FTO.

[41] In view of the above the relevant services rendered were correctly excluded from the zero rating provisions of the subsection.

[42] The Assessors are in agreement with the factual findings.

[43] It follows that the Appeal cannot succeed. In the result the Appeal is dismissed. (This ruling applies to all the tours relevant to the assessment at issue.)

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LE GRANGE, J

(PRESIDENT OF THE TAX COURT)

Assessors:

Mr B.R Hilliard

Mr T.M Pasiwe