

INTERPRETATION NOTE: NO. 39 (Issue 2)

DATE: 8 February 2013

ACT : VALUE-ADDED TAX ACT NO. 89 of 1991 (the Act)
SECTION : SECTIONS 1(1), 8, 11, 16, 18, 23 and 40A
SUBJECT : VAT TREATMENT OF PUBLIC AUTHORITIES, GRANTS AND TRANSFER PAYMENTS

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Preamble

In this Note unless the context indicates otherwise –

- **“the Act”** or **“the VAT Act”** means the Value-Added Tax Act No. 89 of 1991;
- **“the TA Act”** means the Tax Administration Act No.28 of 2011;
- **“the PFMA”** means the Public Finance Management Act No. 1 of 1999;
- **“the MFMA”** means the Municipal Finance Management Act No. 56 of 2003;
- **“the PSA”** means the Public Service Act, Proclamation No. 103 of 1994;
- **“the DOR Act”** means the annual Division of Revenue Act;
- **“the Constitution”** means the Constitution of the Republic of South Africa, Act No. 108 of 1996;:
- **“Commissioner”** means the Commissioner for SARS as defined in section 1 of the TA Act;
- **“Minister”** means the Minister of Finance;
- **“section”** means a section of the VAT Act;
- **“SARS”** means the South African Revenue Service;
- **“VAT”** means value-added tax; and
- any word or expression bears the meaning ascribed to it in the Act.

1. Purpose

This Note –

- sets out the VAT treatment of public authorities, grants and transfer payments and deals with the impact of the amendments in this regard which came into effect on 1 April 2005; and
- withdraws the first issue of Interpretation Note No. 39 dated 4 December 2007, as from 8 February 2013.

This Note intends to provide a clear framework for the application of the law, so that vendors who transact with government departments, public entities and municipalities will have clarity on the application of the Act before and after 1 April 2005 in respect of the following:

- (a) The application of the zero rate in terms of section 11(2)(p) as it read before being deleted, as well as sections 11(2)(n), 11(2)(s), 11(2)(t) and 11(2)(u) which deal with certain payments made by or to public authorities, constitutional institutions and municipalities.
- (b) The application of the deeming provisions in terms of sections 8(5), 8(5A) and 8(23) in respect of certain supplies and payments made by or to public authorities, designated entities and municipalities.
- (c) The difficulties associated with the meaning of the term “transfer payment” as it read before being deleted and the rationale for introducing the definition of a “grant”.
- (d) Determining whether or not an entity is a “public authority”, and consequently, whether that entity must register and account for VAT or not.
- (e) Determining whether certain input tax and output tax adjustments are allowed to, or required by, public authorities.

Important note:

This Note is primarily about the VAT treatment of public authorities and public entities on or after 1 April 2005 as a result of a number of amendments which were made to the Act from that date. However, the Note also explains the pre-April 2005 period to highlight the nature of the issues concerning the application of the law at that time which had to be addressed by the amendments. Although many of the compliance issues relating to the pre-April 2005 period would have prescribed by now, the explanations relating to this period continue to form an integral part of this Note as they explain the rationale behind the current wording and application of the Act.

Extensive amendments to the Act were also made on 1 July 2006 with regard to the VAT treatment of municipalities, but these are only discussed to a limited extent.¹ One of the amendments was that the term “local authority” was substituted by the term “municipality”. Although there are some differences in meaning between these two terms, for the most part they can be used interchangeably for the purposes of this Note. However, to avoid any unnecessary repetition of the term “local authority”, the term “municipality” is preferred with reference to the application of the law between 1 April 2005 and 1 July 2006, notwithstanding any technical differences in the meaning of those terms.

¹ The VAT treatment of municipalities is more fully explained in the *VAT 419: Guide for Municipalities*.

2. Introduction

2.1 Background

Before 1 April 2005, when a vendor received a “transfer payment” from a “public authority”, the deemed supply which arose was subject to VAT at the zero rate in terms of section 11(2)(p) if the payment was received for the purpose of making taxable supplies. This zero-rating provision was introduced as a temporary measure in 1991 when VAT was introduced to allow government departments sufficient time to effect the necessary adjustments to their budgets to take VAT into account. The zero-rating was therefore never intended to be a permanent feature of the Act.

With the rapid transformation of government structures from 1994, many of the functions previously performed by the national and provincial departments were transferred to public entities which had been specifically created to carry on those activities. This meant that the number of payments made between national and provincial departments, municipalities and public entities became more frequent. These payments were also made for a variety of reasons which go beyond what was contemplated in the definition of “transfer payment”. This resulted in many interpretation difficulties because of the different perceptions of the meaning of the term “transfer payment”, as well as the uncertainty around the VAT status of the different types of public entities which were being created at the time.

The definition of “transfer payment” had been amended three times since the inception of VAT to try and clarify the VAT treatment, but differences of opinion remained. In addition, difficulties were experienced with the VAT treatment of equitable share grant payments made to municipalities in terms of the DOR Act, as these did not fall within the definition of “transfer payment”, but were generally perceived to be subject to VAT at the zero rate.

When a public authority or municipality acquires goods from a vendor, it is normally quite clear that an actual taxable supply is made in terms of section 7(1)(a) and there is no need to apply any deeming provision. However, when a third party becomes involved, the position becomes unclear. For example, when a public authority pays for a specific supply of goods or services made by a vendor to a third party, a question arises as to whether the supply is made to the person making payment, or the person receiving the supply. Also, the question arises as to whether there are two supplies to consider for VAT purposes, or only one. This, in turn, created further uncertainty as to the circumstances under which the zero-rating in section 11(2)(p) applied, as it was questionable whether such a payment could ever be regarded as a “transfer payment” as defined. Furthermore, with the intangible nature of services, it is often difficult to establish whether an actual supply of services has occurred or not. This added to the uncertainty as to whether a zero-rated **deemed supply** arose in relation to a particular payment on the basis that it qualified as a “transfer payment”, or if the receipt constituted payment for an **actual supply** of services which was taxable at the standard rate.

This uncertainty resulted in an inconsistent application of the law in respect of certain payments made by public authorities. An investigation was therefore undertaken by National Treasury and SARS to determine what the best practices were in regard to the VAT treatment of public bodies and the grants, subsidies or transfers of funds which they make to other vendors.

Following the investigation, a number of legislative amendments were made with effect from 1 April 2005 to clarify the VAT treatment of public authorities, public entities and the payments which they make or receive.² These changes included, amongst others, the withdrawal of the zero-rating of transfer payments in terms of section 11(2)(p); the introduction of new deeming provisions and definitions; the definition of “public authority” was amended to clarify which listed public entities qualify as public authorities; and the definition of “transfer payment” was deleted. The deleted provisions were replaced by the definition of “grant” and sections 11(2)(s) and 11(2)(t) (among others) were inserted to provide clarity on which payments from government qualify to be subject to VAT at the zero rate.³

A summary of these amendments and the general underlying VAT principles upon which they are based is set out in **2.2** to **2.10** to indicate how they affected various entities.

2.2 General principles

The South African VAT system is based on the premise that government is the final consumer of goods and services if it uses those inputs to provide goods and services on a non-commercial basis. In addition, the classification of public entities under the Schedules to the Public Finance Management Act No. 1 of 1999 (PFMA) is now used as a basis for determining whether the entity concerned should be regarded as an enterprise or not. Since most of the supplies made by departments and certain government agencies are generally outside the scope of VAT, it follows that those departments and government agencies will generally not be entitled to register for VAT or to deduct input tax in respect of the VAT incurred on the acquisition of goods and services. Accordingly, VAT is generally not charged by government on the goods and services it supplies to the public.

Certain public entities which conduct enterprises, as well as welfare organisations and public private partnerships (PPPs) which make taxable supplies, fall within the definition of “designated entity”. If a designated entity receives any payment from a public authority, municipality or constitutional institution, it is deemed to supply a taxable service in terms of section 8(5) to that entity (provided that there is no actual supply in terms of section 7(1)(a) to which that payment relates). The deemed supply is generally taxable at the standard rate, unless the payment is in respect of exempt supplies (e.g. financial services). This is to ensure that entities in which government has an interest do not have an unfair competitive advantage over other vendors

² The bulk of the amendments on this topic are contained in the Revenue Laws Amendment Act No. 45 of 2003 and the Revenue Laws Amendment Act No. 32 of 2004. However, amendments on some of the aspects relating to the topics dealt with in this note are included in the following amendment acts:

- (i) the Taxation Laws Amendment Act No. 9 of 2005;
- (ii) the Taxation Laws Second Amendment Act No. 10 of 2005;
- (iii) the Revenue Laws Amendment Act No. 31 of 2005; and
- (iv) the Second Small Business Tax Amnesty and Amendment of Taxations Laws Act No. 10 of 2006.

³ The legislative amendments were wide-ranging and affected not only aspects which related to the VAT treatment of public entities and public authorities, but also municipalities and municipal entities. However, for practical reasons not all of these changes could be made simultaneously. The legislative amendments were therefore split into two main batches. The first batch affecting mainly public authorities and public entities came into effect on 1 April 2005 whereas the second batch affecting mainly municipalities and municipal entities came into effect from 1 July 2006. Further changes regarding public authorities and public entities dealt with in the 2005 amendments were also included in the 2006 amendments.

participating in the market for the goods or services concerned. However, where a designated entity receives a training grant from a Sectoral Education Training Authority (SETA), or where the grant recipient is a “welfare organisation”, the deemed supply to which that payment relates is taxed at the zero rate.

As discussed later in this Note, a “grant” means any appropriation, grant in aid, subsidy or contribution transferred, granted or paid to a vendor by a public authority, municipality or constitutional institution. A grant is zero-rated in the hands of the recipient (not being a “designated entity”), unless the payment concerned is in respect of an actual supply of goods or services procured directly, or paid for on behalf of a third person by that public authority, municipality or constitutional institution.

The amendments resulted in many of the supplies made by government bodies and public entities no longer being subject to VAT, and meant that those entities were required to deregister for VAT. However, those entities were not required to pay output tax on the value of their assets on the date of deregistration in terms of section 8(2). This was a special measure which was introduced.

Although it might appear that the changes had a significant effect on the financial position of the different entities involved, as well as on the total tax collections of government, the purpose of the investigation into the matter and the subsequent amendments to the law, was to ensure the most efficient and consistent financing of the activities of the different government bodies. The amendments impacted on government's revenue and corresponding changes had to be made to expenditure to adjust the amount of the grants or transfer payments to ensure that the effect of any potential change to the net financial position of the different government bodies and the total tax collections of government were minimised.

2.3 National and Provincial Departments and Public Entities (Schedules 1, 2 and 3 of the PSA and Schedules 3A and 3C of the PFMA)

The VAT treatment of appropriations to national and provincial departments continues to be treated as outside the scope of VAT where the entity concerned does not make supplies which are in competition with other vendors in the private sector of the economy as described in **2.4** below. Similarly, national and provincial public entities listed in Parts A and C of Schedule 3 to the PFMA, are now treated on the same basis as national and provincial departments, as the supplies by these entities are generally of a regulatory, administrative or social nature and are not the same or similar to taxable supplies made by other vendors.

2.4 Taxable or partially taxable national and provincial departments and public entities (Schedules 1, 2 and 3 of the PSA and Schedules 3A and 3C of the PFMA)

If the Minister is satisfied that a department or public entity in **2.3** above (that is, a public authority) makes supplies which are of the same kind or similar to taxable supplies made in competition with other vendors, that specific activity may be regarded as an “enterprise” activity. In such cases, the department or public entity must be notified to register for VAT in respect of those taxable supplies, and to that extent, the entity will be a “designated entity”. The VAT registration may apply to all the activities conducted by that entity, or only for specific activities (as the case may be).

2.5 Constitutional institutions (Schedule 1 to the PFMA)

The activities carried on by Constitutional Institutions are not of a commercial nature, nor is it envisaged that these entities will ever carry on activities in competition with any other vendor in the private sector, or become liable to register for VAT in that regard. The activities of constitutional institutions are therefore excluded entirely from the definition of “enterprise”. Constitutional Institutions were therefore also required to deregister as a result of the amendments to the Act.

2.6 Major public entities (Schedule 2 to the PFMA)

These entities fall within the definition of “designated entity”. Payments to major public entities such as Eskom, Transnet Ltd and Telkom SA Ltd, fall within paragraph (a) of the definition of “enterprise”, and are generally subject to VAT at the standard rate. As these are entities in which government has a commercial interest, they are treated for VAT in such a way that any subsidy from the government is regarded as consideration for a taxable supply. This is to ensure that those payments do not give rise to an unfair advantage over their commercial competitors as a result of the VAT treatment of those payments.

2.7 National and provincial government business enterprises (Schedules 3B and 3D of the PFMA)

These entities fall within the definition of “designated entity”, and are treated for VAT purposes in much the same way as the major public entities in 2.6 above, as their activities fall within paragraph (a) of the definition of “enterprise”. Payments to national and provincial government business enterprises are therefore generally subject to VAT at the standard rate.

2.8 Public private partnerships (PPPs) (Regulation 16 of the Treasury Regulations – section 76 of the PFMA)

A PPP (as defined in the Treasury Regulations) is essentially a partnership between government and the private sector. As such, the activities of a PPP fall within paragraph (a) of the definition of “enterprise”. A PPP also falls within the definition of a “designated entity”, and is treated for VAT purposes in much the same way as a major public entity in 2.6 above. Payments to PPPs are generally subject to VAT at the standard rate, unless the PPP makes exempt supplies as contemplated in section 12.

2.9 Welfare organisations

The amendments to the Act only affect welfare organisations to the extent that they receive and make grants. Textual amendments have been made to the Act so that a “grant” to a “welfare organisation” continues to be zero-rated, as was the case under the previous wording of the Act. A welfare organisation is also a “designated entity”, but the zero-rate applies in this case to unrequited payments which it receives from any public authority, constitutional institution or municipality, if it does not constitute consideration for a taxable supply in terms of section 7(1)(a).

2.10 Municipalities

Supplies by municipalities of goods and services such as electricity, water, gas and removal of sewage, are subject to VAT at the standard rate, and therefore input tax may be deducted in this regard. However, any VAT incurred which is directly attributable to its non-enterprise activities may not be deducted. As a “municipality” is not a “public authority” as defined in section 1(1), the amendments to the Act only affected municipalities to the extent that they receive and make grants, and clarified that equitable share grants received for taxable purposes are zero-rated.

A grant received by a municipality from a public authority, constitutional institution or other municipality, qualifies for the application of the zero rate of VAT. Similarly, a gratuitous payment which qualifies as a “grant” made by a municipality to another vendor which is for the purpose of supporting that vendor’s taxable (enterprise) activities, will be zero-rated in the hands of that vendor. This would not have been the case before the amendments, as only a “public authority” could make a zero-rated “transfer payment”.

Example 1 – Deemed supplies vs actual supplies made by a municipality

If a department (public authority) pays a municipality for the supply of electricity and water used in the course of conducting that department’s operations, the amount paid is not a grant, as it is in respect of an actual supply of goods or services by the municipality to that department. However, if that same municipality receives an “equitable share” payment in terms of the annual DOR Act, to partly cover the cost of providing free water and electricity to certain domestic consumers, that part of the payment will constitute a “grant” in the hands of the municipality.⁴ This is because the department does not receive a supply of goods or services in return for the payment which it makes to the municipality.

The effect is that the supply of water by the municipality to domestic consumers (which is a taxable supply), is partly subsidised by the “equitable share” paid by the government. Therefore, to the extent that the “equitable share” is paid to the municipality to enable or assist it to make taxable supplies, the payment will constitute a “grant” and will be subject to VAT at the zero rate.

2.11 Other private sector vendors (not being designated entities)

It has always been a requirement that a “transfer payment” can only qualify as a zero-rated receipt in the hands of the recipient vendor if the amount received does not constitute “consideration” for an actual supply of goods or services made by that vendor in terms of section 7(1)(a). A similar rule applies on or after 1 April 2005 in regard to the receipt of a grant. Grants can, however, be made by public authorities, constitutional institutions and municipalities. The amendments to the Act therefore did not have a substantial effect on private sector vendors except to clarify further that payment for any actual supplies procured directly by the person making the payment, or which are paid for on behalf of a third person are subject to the standard rate, and cannot qualify as being in respect of zero-rated deemed supplies.

⁴ This example applies on or after 1 April 2005. Before 1 April 2005, payments in terms of the DOR Act were not specifically dealt with in the VAT Act. As such a payment was not a “transfer payment” as defined, it would not have qualified for the zero rate in terms of section 11(2)(p).

Example 2 – Deemed supplies vs actual supplies – research

The Department of Trade and Industry (DTI) allocates a certain amount of public funds each year to the National Research Foundation (NRF), for the funding of innovation and other initiatives. The NRF is listed in Schedule 3A of the PFMA, and therefore it is a “public authority” in terms of the amended definition of that term. A payment received by vendor (not being a “designated entity”) from the NRF, is deemed to be a supply in terms of section 8(5A) and will qualify as a zero-rated “grant” in terms of 11(2)(f). This is provided that the NRF or the DTI does not acquire the ownership of any assets (including intellectual property rights) and does not receive any other goods or services (for example, actual research outputs) in return for the payment to that vendor. In other words, the receipt can only constitute a zero-rated grant if it does not constitute payment of consideration to that vendor for the reciprocal taxable supply of actual research services.

2.12 Special cases (unlisted entities)

Section 47 of the PFMA reads as follows regarding unlisted public entities:

- (1) The Minister, by notice in the national *Government Gazette*—
 - (a) must amend Schedule 3 to include in the list all public entities that are not listed; and
 - (b) may make technical changes to the list.
- (2) The accounting authority for a public entity that is not listed in either Schedule 2 or 3 must, without delay, notify the National Treasury, in writing, that the public entity is not listed.
- (3) Subsection (2) does not apply to an unlisted public entity that is a subsidiary of a public entity, whether the latter entity is listed or not.
- (4) The Minister may not list the following institutions in Schedule 3:
 - (a) A constitutional institution, the South African Reserve Bank and the Auditor-General;
 - (b) any public institution which functions outside the sphere of national or provincial government; and
 - (c) any institution of higher education.

This means that the following are special cases which do not fall naturally into any of the categories dealt with in **2.3 to 2.9** –

- (i) the South African Reserve Bank (SARB) and the Auditor-General (AG);
- (ii) entities in the process of being created and listed (*see 7.7 for more details*);
- (iii) any public institution which functions outside the sphere of national or provincial government; and
- (iv) any institution of higher education.

It follows that the SARB and the AG will be regarded as normal enterprises under paragraph (a) of the definition of “enterprise”. The same principle will apply to the entities in (ii), (iii) and (iv) above, to the extent that they may be regarded as making taxable supplies (unless the Minister decides otherwise).

3. The law before 1 April 2005

The wording of the relevant provisions which had to be considered in regard to the zero-rating of transfer payments made by public authorities is quoted in **Annexure A – Part 1**. The provisions are quoted as they read immediately before being amended or deleted on 1 April 2005.⁵ Note, however, that subsequent amendments were also introduced on 1 July 2006 when the new rules relating to the VAT treatment of municipalities were introduced. The relevant provision will be followed by a note to indicate the effect of those further amendments.

4. Application of the law before 1 April 2005

The wording of the provisions quoted in **Annexure A – Part 1** is analysed and interpreted below. Although the explanations provided in this paragraph are given in the past tense, they will continue to apply in the context of the amended law to the extent that the law retains its original wording. For example, paragraph (b)(i) of the definition of “enterprise” remains largely unchanged by the amendments, so the explanation of the law in **4.1** and **4.1.1** as it relates to public authorities remains largely the same after 1 April 2005, as will the explanations provided with regard to the definition of the term “services” and the application of section 11(2) with regard to the zero-rating of services in general. Similarly, before 1 April 2005, section 8(5) was a general deeming provision applicable to all vendors in regard to certain payments received from public or local authorities, but from 1 April 2005, the wording was amended so that it only applies to a “designated entity”. The interpretation of the wording of this provision is set out in **4.6**.

4.1 Definition of “enterprise” [Paragraph (b)(i) and (c)]

Paragraphs (b)(i) and (c) of “enterprise” (before the deletion of paragraph (c) on 1 July 2006) referred to the supplies made by public authorities and local authorities respectively. These paragraphs identified the different types of supplies made by these entities which are similar to, or which compete equally with, supplies which would be made by any other vendor in terms of paragraph (a) of the definition which should be regarded as taxable supplies. In the case of public authorities, this business rationale, or business test, forms an integral part of the thinking behind the notification process. However, in the case of municipalities, the business test was embedded in the wording of paragraph (c) of the definition. The intention behind the wording of these provisions was that the activities concerned should be conducted as far as possible with normal business principles and motivations in mind. This will include, for example, the assumption that the activity will at least be self-sustaining so that that the costs incurred to conduct the activity will be less than the income generated once the business infrastructure is in place.

4.1.1 Paragraph (b)(i) – public authorities

These entities exist to carry out the work of national and provincial government. The supplies made are therefore not normally of the same type or nature found in the private sector, nor are they in competition with vendors in that sector. The supplies made are therefore usually in the context of carrying out a regulatory, administrative or stewardship function of government. In order for the supplies under this subparagraph to be treated as “enterprise” activities, the public authority concerned had

⁵ As the law is quoted as it read at the time, the definitions continue to be quoted under section 1 and not section 1(1) which is the current reference as a result of the amendments which became effective on 1 October 2012 with the introduction of the TA Act.

to be notified to register for VAT in that regard by the Commissioner, acting on instruction from the Minister. The Minister, in turn, had to be satisfied that the supplies (or certain of them) were of the same kind or similar to taxable supplies already being made, or which might be made by vendors in the private sector.

Certain public authorities and supplies made by them were identified and published in a media statement dated 27 September 1991. The entities listed in the media statement were the only public authorities that had been notified to register before the amendments in April 2005. However, as mentioned in **2**, since 1994 the responsibility for performing certain functions of government has been taken over by other government agencies or public entities. Some of these entities were created by an Act of Parliament and others had their own enabling legislation. In some instances the work has been wholly or partially outsourced to private organisations.

This created some uncertainty as to whether public entities which performed functions on behalf of, or instead of a department would be liable to be registered in terms of the normal rules in terms of paragraph (a) of the definition of “enterprise”, or if they were to be regarded as public authorities for VAT purposes, and therefore not be liable to register for VAT unless notified to that effect in terms of paragraph (b)(i) of the definition of “enterprise”. It followed that some public entities registered for VAT without being notified, whilst others did not register. One of the objectives of this Note when it was first published on 4 December 2007 was to provide some certainty in respect of the liability of those entities to register, and to deal with the consequences of their registration or non-registration for VAT purposes.

4.1.2 Paragraph (c) – local authorities

Local authorities exist to bring the resolution of governance issues as close as possible to the people of a particular community, and to ensure the provision of certain basic services and facilities. A “municipality” as it is now called is part of local government which forms the third tier of government. Local government must strive within its financial and administrative capacity to achieve the following objectives as set out in section 152(1) of the Constitution:

“...the objects of local government are—

- (a) to provide democratic and accountable government for local communities;
- (b) to ensure the provision of services to communities in a sustainable manner;
- (c) to promote social and economic development;
- (d) to promote a safe and healthy environment; and
- (e) to encourage the involvement of communities and community organisations in the matters of local government.”

At this level of government, some of the goods and services provided are similar to goods and services supplied by other vendors. Local authorities were therefore sometimes regarded as being in competition with the private sector in respect of specific types of supplies, but not so in respect of others. The following supplies by local authorities have always been treated as taxable, regardless of whether those supplies were made in competition with the private sector, or whether the activity was profitable or not:

- (i) Electricity, gas or water;
- (ii) Drainage, removal or disposal of sewage or garbage; and

- (iii) Goods or services which are considered incidental to or necessary for making the supplies in items (i) and (ii) above.

When it came to any other types of supplies mentioned in paragraph (c)(iv) of the definition as it read before being deleted, **all** of the following requirements had to be met before the supplies could be regarded as taxable:

- The supplies must be of the same kind or similar to taxable supplies made by any other vendor.
- The income derived from the activity (including any grant or subsidy for conducting the business activity) should be sufficient to cover all the costs of conducting that activity (including a reasonable provision for depreciation, but excluding capital expenditure).
- The business activity must fall within the category of businesses determined by the Minister published in Government Notice No. 2570 – 21 October 1991; or, if the activity is not on that list, the Minister must advise the specific local authority that it shall treat the business activity concerned as an enterprise activity.

Government Notice No. 2570 (21 October 1991) listed the categories of businesses for the purposes of item (cc)(A) of paragraph (c)(iv) of the definition of “enterprise” as it read at the time. Government Notice No. 2570 was later withdrawn when various amendments to the Act came into effect on 1 July 2006 with regard to the VAT treatment of municipalities (including the deletion of paragraph (c) of the definition of “enterprise”).⁶

4.2 Definition of “local authority”

As mentioned in 4.1, a “local authority” was regarded as part of local government being the third tier of government. The purpose of local government is essentially to decentralise certain functions of government so that the local community can have more control over the governance issues which impact on their daily lives in the regions in which they live. The term “local authority” as it was defined at the time included –

- various councils and boards which had authority or jurisdiction over the administration of the affairs of a particular town, city, village, municipality or other area where people live;
- other bodies, committees and institutions which were similar to the above entities which under any law carry out similar functions and which were allowed to levy rates on certain immovable property within its area or receive payments for services rendered or to be rendered;
- any water board or regional water services corporation or any other institution which had powers similar to those of any such boards or corporations;
- Joint Services Boards (JSBs) and Regional Services Councils (RSCs) which were entitled to raise levies at the time, payable by certain persons (normally businesses) in the area; and

⁶ Municipalities now fall within paragraph (a) of the definition of “enterprise”.

- Transitional Metropolitan Councils (TMCs) where several local authorities had either merged with, or been taken over by another local authority.⁷

As can be seen from the aforementioned, the number of different entities that could qualify as a local authority was fairly wide. Only some of these would qualify as a “municipality” which is a much narrower term.⁸

4.3 Definition of “public authority”

This term was defined as –

“any department or division of the public service (including a provincial administration, the South African National Defence Force, the South African Police Service and Correctional Services)”.

As the defining line between public authorities and public entities became somewhat blurred over the years, uncertainty was created as to the VAT status of certain public entities (i.e. the distinction between government “departments” and other government “agencies” was unclear).

Since the terms, “department”, “division of the public service”, and “provincial administration” were not defined for VAT purposes, it was important to explore other legislation to determine the intended meaning. Whether a particular entity could be regarded as a public authority for VAT purposes was essential for two main reasons, namely –

- a “public authority” must be notified to register for VAT in terms of paragraph (b)(i) of the definition of “enterprise”. If the entity did not fall within the ambit of the definition of a “public authority”, either paragraph (a) or (c) of the definition of “enterprise” could apply (that is, no notification would have been required); and
- only a “public authority” could make a “transfer payment”. It follows that the zero rate in terms of section 11(2)(p) could only apply where the deemed supply in section 8(5) arose as a result of a payment received from a public authority.

To determine if an entity was a “public authority” as defined, one had to examine the aims of the Act in terms of which the entity was established (if any), the nature, functions, powers and funding of operations, the reporting structures and responsibilities of the organisation, and so on. However, even after conducting this exercise, there was still uncertainty, and in some cases, it became necessary to consult other legislative sources for guidance in this regard. In terms of section 40(1) of the Constitution, “government” is described as being “*constituted as national, provincial and local spheres of government which are distinctive, interdependent and interrelated*”.

It can therefore be concluded that the term “public authority” referred to the first two tiers of government (that is, national and provincial spheres), whereas the term “local authority” referred to the third tier of government.

⁷ For VAT purposes, the disestablished local authority and the new local authority were treated as one and the same entity.

⁸ The Municipal Demarcation Board established by section 3 of The Local Government: Municipal Demarcation Act, 1998 is responsible for determining municipal boundaries and district management areas.

The PSA and the PFMA were also referred to for guidance for the following reasons:

- The public service established by section 197(1) of the Constitution is structured and organised as provided for in section 7 of the PSA.
- The PFMA classifies public entities into two broad categories which are useful for VAT purposes, namely, business and non-business⁹ In addition, it sets out government's expectations with regard to the financial and functional accountability of the different types of public entities.

In terms of section 1 of the PFMA a "department" means a "national or provincial department" and makes reference to Schedules 1 and 2 of the PSA. The term "public service" is not defined in the PFMA. The term "department" as defined in section 1 of the PSA means a "national department", a "provincial administration" or a "provincial department". The meaning of these terms is derived from section 7(2) of the PSA; which states as follows:

"For the purposes of the administration of the public service there shall be national departments and provincial administrations mentioned in the first column of Schedule 1, provincial departments mentioned in the first column of Schedule 2 and the organisational components mentioned in the first column of Schedule 3."

The PSA indicates that the meaning of the term "public service" is as contemplated in section 8 of the PSA- "*Composition of public service*". This provision indicates essentially that the public service consists of persons who hold posts on the "fixed establishment" (i.e. posts created for the normal requirements of a "department"), including temporary and contract employees in addition to the fixed establishment.

From both the PSA and PFMA, it can be concluded that a "department" before 1 April 2005 was interpreted to mean any entity listed in Schedules 1, 2 or 3 of the PSA. (*Refer to Annexure B.*) It is also submitted that the interpretation principles *noscitur a sociis* and *eiusdem generis* apply in respect of the terms "division of the public service" and "department" as discussed above (i.e. they are very closely associated, and each "takes their colour" from the meaning of the other).

Generally, VAT legislation treats divisions, separate enterprises or branches in a very similar manner, which implies that these terms have very similar meanings. The term "division" is defined in the Collins English Dictionary as –

4. one of the parts, groups, etc., into which something is divided
5. a part of a government, business, country, etc, that has been made into a unit for administrative, political or other reasons".

"Branch" is defined in The Shorter Oxford English Dictionary as –

5. [a] division; a subdivision; a department
6. A component portion of an organization or system
- 7.. A local and subordinate office of business".

⁹ The PFMA promotes the objective of good financial management within the public sector to maximise service delivery through the effective and efficient use of the government's limited resources. The PFMA came into effect from 1 April 2000 and gives effect to sections 213 and 215 to 219 of the Constitution which applies to the national and provincial spheres of government.

In the case *S v Coetzee 1927 3 SA 526 (O) 529*, it was held that, to be a branch, two requirements must be satisfied, namely –

- the entity must purport to be a branch or “section” of the main body; and
- its objects and activities must substantially conform to those of the main body.

An entity was therefore only regarded as a “public authority” for VAT purposes before 1 April 2005 if it was listed in Schedules 1, 2 or 3 of the PSA (including any organisational component of that entity such as an office, division, subsidiary, separate trading account, or branch whose objects and activities substantially conform to those of the main body which it purports to represent). Therefore, as the scope of the term “public authority” before 1 April 2005 was interpreted so that it did not include any of the entities listed in the PFMA, those entities would have been liable to register for VAT in terms of paragraph (a) of the definition of “enterprise” if they made taxable supplies in excess of the registration threshold in section 23(1).¹⁰

This meant that for the period before 1 April 2005, there was a potential VAT consequence for those public entities which were liable to register, but did not do so as a result of the uncertainty. (See *proviso to section 23(4) and the explanation of application of that provision in 6.13.*)

The “outsourcing” of activities normally performed by a public authority to private independent businesses did not mean that the entity performing those activities would fall within the ambit of the definition of a “public authority”. Similarly a partnership or joint venture between a government department or division thereof and a private independent contractor would also fall outside the scope of the definition of a “public authority”. (For example, a “public-private partnership” as contemplated in the Regulations to the PFMA – usually referred to as a PPP.)

4.4 Definition of “services”

The term “services” means 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. The definition is meant to be as broad and all-inclusive as possible, but it excludes a supply of goods, and a supply of money. Therefore, if a particular transaction does not constitute a supply of “goods” or “money”, it should generally fall within the definition of “services”.

To fall within the scope of the Act, a payment (consideration) must be received by a vendor in respect of taxable “supply” made by that person. This can be an actual supply, or a supply which the Act deems the person to make in the circumstances. It follows that a donation will not be subject to VAT as such a payment is given unconditionally and does not constitute payment for a supply of goods or services to the donor. It is also worth noting that in our law, there is a presumption against the making of a gratuitous payment (donation) unless the facts and circumstances indicate the contrary.¹¹ It follows that a person does not merely part with money or goods, or make available facilities or advantages to another person without some

¹⁰The current registration threshold effective from 1 March 2009 is R1 million. The registration threshold value was R150 000 before 24 November 1999 and R300 000 from that date until it changed on 1 March 2009.

¹¹Refer for example, to *Myers v Lesch 1954 (2) SA 487 (T)* and *Jepson NO v Lezar (6453/2007) [2009] ZAFSHC 49*.

form of *quid pro quo* (mutual consideration, equal exchange, or something given in return for that which is received).

One of the main issues with the application of the law in this regard was that public and local authorities often incorrectly assumed that certain payments made to vendors to make supplies of goods or services related to the delivery of government services and assistance programmes to the public constituted transfer payments which were subject to VAT at the zero rate. Such payments should instead have been treated as consideration for the actual acquisition of goods or services which are subject to VAT in accordance with the normal rules.

In the absence of a written contract, it was often unclear whether a vendor could be regarded as having actually rendered a service to the public authority or local authority making the payment. In other words, it was sometimes difficult to establish if there was a sufficiently strong link between a particular payment and specific performance of any identifiable services in return for that payment. (See **4.5** on the meaning of the term “transfer payment” for more details and Example 3 below which illustrates the point.)

Example 3 – Different perceptions in regard to certain payments from government

Consider a payment made by a government department to a vendor as an incentive for innovation in developing South African produced goods. The possible perceptions of the parties to the transaction could have been any of the following:

- The department may have perceived that the vendor was supplying a valuable service, in that it assisted that department to fulfil its mandate in meeting the country’s export objectives. However, the vendor’s view may have been that there was no link between the payment and any specific identifiable service supplied in return to that department; or
- The vendor might have viewed the payment as consideration for conducting the enterprise in a particular manner which was intended to compensate for the possible sacrifice of other business opportunities. On the other hand, the department’s view may be that it was distributing the funds to that vendor as well as many others as part of its (benevolent) mandate, and therefore, the vendor did not really supply any specific, identifiable or valuable service to the department in return; or
- Neither party perceived that there was a service supplied in return for the payment; or
- Both parties regarded the payment as being consideration in respect of a specific service supplied by the vendor to the public authority.

This matter was dealt with in VAT NEWS 17 (August 2001 issue) to clarify that where there was an actual supply of goods or services in terms of section 7(1)(a) to a government department, section 8(5) did not apply, and hence the zero rate in terms of section 11(2)(p) did not apply. In a letter from SARS Head Office to all SARS offices dated 31 March 2003, the official interpretation on this point was set out as follows:

“This office’s interpretation of the current legislation is that in the circumstances where a Government Department, Provincial or National Government makes

available transfer payments, grants, subsidies or any payment to a vendor and such government department receives a benefit of either goods or services in return for making such payment, then the services supplied by that vendor will no longer fall within the ambit of sections 8(5) and 11(2)(p) of the Value-Added Tax Act, 1991. An actual supply of a service takes place which will be taxable at the standard rate in terms of the provisions of sections 7(1)(a) of the Act.”

4.5 Definition of “transfer payment”

As previously mentioned, various attempts were made over the years to clarify the meaning of the term “transfer payment”. From government’s perspective, if transfer payments were taxable at the standard rate, state expenditure increased, but more VAT (government income) was collected. If transfer payments were zero-rated, state expenditure did not increase, but VAT collections would be less – the net effect on the state being the same.

Initially, this term was defined –

“as contemplated in para 1.2.9.3 of the Manual on the Financial Planning and Budgeting System of the State published in terms of s39 of the Exchequer Act 66 of 1975”.

In a media statement dated 28 September 1991, examples of transfer payments were given as being payments by a government body to or in respect of the Council for Scientific and Industrial Research (CSIR), the South African Bureau of Standards (SABS), the Urban Foundation, decentralisation assistance payments, and subsidies under the General Export Incentive Scheme (GEIS). As a result of continued uncertainty, a further media statement dated 18 October 1993 was issued.

The definition as set out in the *Manual on Financial Planning and Budgeting of the State* was quoted as follows:

“Transfer payments refer to amounts which will not be disbursed on goods or services by the department/administration on whose vote they appear, but will be paid over to other bodies. Included herein ... divided in two categories, viz:

Current transfers which include grants in-aid, subsidies, contributions, financial assistance and aid in natura to foreign countries as well as pensions and social benefits,

Capital transfers consisting of ordinary capital transfers, acquisition of shares and loans granted.”

The definition was amended when the Exchequer Act was repealed and replaced by the PFMA and the publishing of Treasury Regulations for departments, constitutional institutions and trading entities published in *Government Gazette* No. 21249 dated 31 May 2000 as follows:

“...all transfers excluding–

- (a) all division of revenue grants from the national government; and
- (b) any transfers to constitutional institutions and individuals.”

The definition subsequently referred to a “transfer payment” as contemplated in regulation 8.4 of the Treasury Regulations published in terms of the PFMA.

In terms of section 214(1) of the Constitution, the annual DOR Act is required to provide for –

- “(a) the equitable division of revenue raised nationally among the national, provincial and local spheres of government;
- (b) the determination of each province’s equitable share of the provincial share of that revenue; and
- (c) any other allocations to provinces, local government or municipalities from the national government’s share of that revenue, and any conditions on which those allocations may be made;”

According to GG No. 21249 dated 31 May 2000, “division of revenue grants” refers to allocations from the national government to other spheres of government as listed in Schedules 3A, (Grants to provinces) 3B (Grants for Local Government functions) and 3C (Grants still to be divided between spheres) of the DOR Act, 2000 including transfers in terms of section 16 (transfers not listed in the schedules to the DOR Act).

Government Gazette No. 22219 dated 9 April 2001 and *Government Gazette* No. 23463 which came into effect on 27 May 2002 defines “division of revenue grants” as:

“allocations from the national government to provinces and local government as listed in the schedules to the annual Division of Revenue Act, including transfers in terms of that Act.”

It followed from these provisions, that a “transfer payment” (as defined), did not include a grant, “equitable share” distribution, “Municipal Infrastructure Grant” or any other appropriation paid in terms of the DOR Act before 1 April 2005. Note, however, that section 40A was introduced to provide relief in the case of certain assessments raised because of this incorrect treatment. A similar provision in the form of section 40B was also introduced later to provide similar relief for payments made in terms of the DOR Act before 1 April 2005. (*For more information on section 40B, refer to the VAT 419: Guide for Municipalities which is available on the SARS website*).

In summary, a transfer payment which was zero-rated in terms of section 11(2)(p) could be described as follows:

- It was an amount which had been budgeted for, and paid over to other institutions or persons by a public authority (i.e. a payment is made by an entity in national or provincial government to a vendor); and
- The vendor receiving the payment did not provide any goods or services in return to the public authority itself. Instead, it received the payment as financial assistance from the state which was directed at supporting the enterprise activity of that vendor as a whole so that the vendor could continue to make taxable supplies to its customers.

The term “transfer payment” excluded–

- transfers to constitutional entities and individuals (non-trading entities);
- transfers in terms the DOR Act such as “equitable share” distributions to provinces and local government as listed in the schedules to the annual DOR Act, including transfers in terms of that Act;
- a transfer by a local authority or a public entity listed in the PFMA to a vendor (unless the local authority or public entity is, in terms of an agreement, merely

acting as the legal agent of the public authority concerned in disbursing that payment); and

- payment for a specific supply made to the public authority making the payment, or payment for a specific (actual) supply made at the instruction of the public authority to a third person.

Where a payment was made to a vendor by a public entity listed in Parts A & C of Schedule 3 to the PFMA in its capacity as the principal grant provider, that payment does not qualify as a “transfer payment”, and could therefore not be zero-rated in terms of section 11(2)(p) in the hands of the recipient. Alternatively, it would not have been regarded as a receipt by that PFMA entity at all if it was merely acting as the agent as contemplated in section 54. Otherwise, if the public entity was not acting as agent on behalf of the public authority, it had to be established if the payment was in respect of an actual supply of goods or services in terms of section 7(1)(a), or if the payment was unrequited.

Refer to **Annexure D** for examples of transfer payments.

4.6 Section 8(5) – Certain supplies of goods or services deemed to be made or not made upon receipt of payments from public and local authorities

“For the purposes of this Act ...”

The deeming provision contained in section 8(5) is applicable only for the purposes of the VAT Act.

“...a vendor shall be deemed to supply services to any public authority or local authority...”

A vendor could under certain circumstances be deemed to supply a service to a public or local authority (that is, if any payment was received from the authority) where there is no actual supply of goods or services made in response to, or in respect of that payment in terms of section 7(1)(a). Since “services” means *“anything done or to be done...”*, the payment can relate to a taxable supply that had already taken place, or to a supply that was still to be made in the future.

“...to the extent of any payment made by the authority concerned...”

The services were deemed to be supplied when and to the extent that any payment was made by a public or local authority in respect of the taxable supply of goods or services by the vendor. This means, for example, that if a vendor qualified for a grant for enterprise purposes which was payable in tranches over a period of time, the deemed supply only arises to the extent of the payments actually received by that vendor in the tax period and not the full amount of the subsidy at the time that it was approved or made available for payment by the public authority.

“... to or on behalf of the vendor...”

The payment did not necessarily have to be received by the vendor personally. The payment could also be made on that vendor’s behalf to the vendor’s agent, or other person who could have applied the payment for that vendor’s benefit. For example, payment could be made to another person to whom the vendor owed money, thus reducing or extinguishing that debt. Note, however, the earlier comments in **2.1** and at the end of this subparagraph about the uncertainty which was brought about by payments being made directly to third parties.

“... in respect of the taxable supply of goods or services by the vendor...”

There could only have been a deemed supply by a vendor to the public or local authority if there were two elements present, namely –

- the payment had to be made by a public or local authority; and
- there had to be a link between the payment and the purpose of making taxable supplies of goods or services by that vendor to other persons.

In various income tax cases with regard to services rendered, the words *“in respect of”* have been held to mean *“...stands in a direct causal relationship to the services rendered by him”*. In this context, there must have been a clear link between the purpose for which the payment was made by the public or local authority, and the application of those funds in the vendor’s enterprise which assists that person to make taxable supplies of goods or services to its customers. The payment could therefore not give rise to a deemed supply by the vendor in terms of section 8(5) if the payment was in respect of exempt supplies, or other non-taxable supplies made by the vendor.

“... to any person”

The term “any person” in this context means any person other than the public or local authority making the payment. In terms of section 6 of the Interpretation Act No. 33 of 1957, the term “any person” (singular) could also mean “any persons” (plural).

Part of the uncertainty in regard to the application of section 8(5) was that some vendors adopted the view that as long as the payment came from a public or local authority, the receipt was subject to VAT at the zero rate. This view was contrary to the meaning of a “transfer payment” being unrequited financial support to cover the capital and operational expenses of certain businesses that make taxable supplies which government regarded as worthy of this support, or which was required by government subsidy programmes. It was never intended as a way of extending the zero-rating provisions of section 11. The result of this misunderstanding was that a number of vendors were assessed for having incorrectly applied the zero rate to payments for actual supplies of goods or services made either to third persons, or to the public or local authorities who procured those supplies for their own benefit. The incorrect interpretation of this provision also led to public authorities and local authorities making errors with regard to the budgeting of organisational costs and the cost of project deliverables when outsourcing tasks to third parties.

Example 4 – Innovation subsidy

The Department of Science and Technology (public authority) pays a vendor part of the R30 000 which that vendor is entitled to as part of a subsidy programme to chicken farmers to promote the innovation of new methods of increasing production of disease-free chickens. Payment of R10 000 was made on 1 July 2003 and a further R20 000 would be paid on production of actual evidence showing the innovative technique or invention being viable in practice to cover further development expenses and the lodging of patents etc. In this case, the vendor would have declared output tax at the zero rate on R10 000 in the tax period covering 1 July 2003. If the vendor received the balance of R20 000 on 15 August 2004, the amount would have only been declared at that later date, since the deemed supply is only made *“to the extent of any payment made by the authority.”*

In this example, the vendor does not make any actual supplies to the public authority because the intention of the department was to subsidise the taxable part of the business to promote its production and breeding techniques. The public authority in these circumstances is not regarded as having paid the vendor to acquire any technology or invention, as the results will be used in the vendor's business to enable it to improve the quality and quantity of taxable supplies made to its customers.

Another major issue which arose with the application of section 8(5) was that payments to municipalities and other entities in terms of the DOR Act were not dealt with specifically in the law. This meant that the deemed supply which arose in the hands of the recipient vendors in terms of section 8(5) were not subjected to a similar zero-rating as was the case with transfer payments in terms of section 11(2)(p). Municipalities in particular were affected by this situation.

4.7 Section 11(2) – Zero-rating – Services

“Where, but for this section, a supply of services would be charged with tax at the rate referred to in section 7(1)...”

Section 11(2) contains a list of services and the circumstances under which 0% VAT is applicable. The supply being considered in this section must be of the type that would otherwise have been subject to the standard rate, had this provision not been in the Act.

The supply of any exempt services listed in section 12 or services otherwise than in the course or furtherance of an “enterprise” are therefore excluded. However section 11(2) overrides sections 12(a) (international financial services) and 12(g) (international transportation services), so that these specific supplies are also included in the scope of application of this provision (i.e. they are not precluded from being zero-rated instead of exempt in certain cases).

“...such supply of services shall, subject to compliance with subsection (3) of this section,...”

As with all supplies mentioned in section 11, there is a condition that the vendor must obtain and retain documentary proof acceptable to the Commissioner which substantiates the application of the zero rate. (Refer to Interpretation Note No. 31 (Issue 2) “Documentary Proof Required for the Zero-Rating of Goods and Services” dated 30 March 2012 for the prescribed documents.)

“...be charged with tax at the rate of zero per cent where —...”

The zero rate applies only where the specific circumstances mentioned in the various sub-paragraphs to section 11(2) are applicable. For example, for a payment to have been zero-rated in terms of section 11(2)(p), the various conditions set out in sub-paragraph (p) had to be met as set out in **4.8**.

4.8 Section 11(2)(p) – Zero-rated “transfer payment”

“the services are in terms of section 8(5) deemed to be supplied to a public authority...”

Section 11(2)(p) could have only applied where there was a deemed supply in terms of section 8(5), as discussed in **4.6** and **4.7** above. This could only be the case if there was no actual supply of goods or services to the public authority in return for that payment, and that the receipt did not constitute consideration for an actual

supply to a third person at the instruction of the public or local authority making the payment. The reason is that such a payment would not have qualified as a “transfer payment”, as discussed in 4.5. Furthermore the supply must have been deemed to be made to a public authority as it was not possible for a local authority or a public entity listed in the PFMA to make a transfer payment.

“... to the extent that the payment contemplated in that section consists of a transfer payment; ...”

“..[T]he payment contemplated in that section...” was a reference to the payment in section 8(5) which was made by the public or local authority, which in turn, gave rise to the deemed supply. A deemed supply could arise in terms of section 8(5) in many different situations where payment was made by a public or local authority for the benefit of a vendor making taxable supplies. However, the application of the zero rate in terms of section 11(2)(p) was restricted to situations where the deemed supply arose in respect of the receipt of a “transfer payment” (as defined) which was made by a public authority. This provision could therefore not apply to payments received from local authorities, or public entities listed in the PFMA, regardless of whether they were gratuitous in nature, or not.

In the case of a composite amount being received from a public authority which was made up of different payments for different purposes, the individual amounts had to be identified and attributed accordingly. Only that part of the payment which qualified as a “transfer payment” as discussed in 4.5 above would have been subject to the zero rate under this provision.

Similarly, if a payment was for the purpose of both exempt and taxable supplies made, or to be made by the vendor, only the part that was properly attributable to taxable supplies qualified as a zero-rated “transfer payment”. Payments received wholly or partially for the purposes of exempt supplies made by a vendor, would have been out-of-scope (non-taxable) for VAT purposes¹² even if such a payment qualified as a “transfer payment” as defined. This is because a deemed supply in terms of section 8(5), and consequently, the zero rate in terms of 11(2)(p), could only apply to the extent that the amount was received for enterprise purposes (taxable supplies).

As mentioned in 4.6, one of the major issues which arose was the incorrect treatment of appropriations paid in terms of the annual DOR Act, which did not qualify as zero-rated transfer payments. The interpretation of the VAT treatment of such payments received before 1 April 2005 is, therefore, that they are taxable at the standard rate and cannot be subject to VAT at the zero rate in terms of section 11(2)(p).¹³

Any payment from a public or local authority which was not a “transfer payment” also had to be taken into account for the purposes of calculating the apportionment percentage in terms of section 17(1). For example, when the turnover based method of apportionment was used, payments received in terms of the DOR Act would have been added to the numerator of the formula to the extent that they were received for the intended purpose of making taxable supplies, and the full amount should have been included in the denominator of the formula.

¹² Examples include share purchases in government businesses and passenger transport subsidies paid to businesses that transport fare-paying passengers by road or rail. (Refer to sections 2(1)(d), 2(1)(12(g) and 12(a).)

¹³ Note, however, the comment in 4.5 about the introduction of section 40A, and later, section 40B to provide relief in the case of certain assessments raised because of this incorrect treatment.

5. The law on or after 1 April 2005

The wording of the amended law is quoted in **Annexure A – Part 2**.

6. Application of the law on or after 1 April 2005

The various amendments to the law in **Annexure A – Part 2** are analysed and interpreted in **6.1 to 6.14** below. Note that the general principles and meaning of certain terms which were explained in the application of the law in **4** are not repeated here, but rather referred to as a cross-reference where necessary. Where those principles and concepts still apply on or after 1 April 2005, they are used as a foundation to augment the analysis and interpretation of the amendments to the law, so that the position after 1 April 2005 may be clearly distinguished from the position before that date.

6.1 Definition of “enterprise” [Paragraph (b)(i)]

Although no amendments were made to paragraph (b)(i) of the definition of “enterprise”, the application of this provision changed because of the amendment to the definition of a “public authority” which now includes certain public entities.

Before the amendment, it was not clear whether certain public entities would be liable to register under paragraph (a) of the definition of “enterprise”, or if paragraph (b)(i) of the definition applied. The amendment therefore clarified that the activities of national and provincial public entities listed in Parts A or C of Schedule 3 to the PFMA (non-business type classification) fell within paragraph (b)(i) of the definition of “enterprise” as these entities are regarded as public authorities with effect from 1 April 2005. (See *explanation on the definition of “public authority” in 6.5 below.*)

Unless the said entities make taxable supplies which are similar to those in the private sector and have been notified by the Commissioner to register (pursuant to the Minister’s decision), their activities are generally out-of-scope for VAT purposes and they will not register for VAT. Public authorities and public entities listed in Parts A or C of Schedule 3 to the PFMA which were registered before 1 April 2005 were therefore required to deregister with effect from that date. Relief from the output tax normally due on this taxable event is provided to these entities in terms of proviso (iv) to section 8(2). (See **6.7 below regarding the application of this provision.**)

The activities of public private partnerships (PPPs) or other joint business ventures between government and private entities fall within paragraph (a) of the definition of “enterprise” and not paragraph (b)(i).

The VAT status of an entity may be affected if it has not yet been classified or is re-classified by the Minister in terms of the PFMA. Usually the effective date of the classification or re-classification as published in the *Government Gazette* will be the date of liability, or the date on which the liability to register for VAT purposes ceases (as the case may be). However, in certain cases where the effective date of that classification or re-classification is considered to be inappropriate, National Treasury and SARS may determine another date which is reasonable in the circumstances taking into account all the relevant circumstances and conditions prevailing for that entity (or other entities in a similar position).

One of the implications of the amendment to the definition of “public authority” was that the National Skills Fund (Department of Labour) and the Sectoral Education

Training Authorities (SETAs) (both Schedule 3A PFMA entities) no longer qualified to be registered for VAT and were therefore also required to deregister. Consequently, vendors who are liable to pay the Skills Development Levy (SDL) in terms of the Skills Development Levies Act, 1999, are no longer allowed to deduct input tax on SDL payments for periods on or after 1 April 2005.

The same rule applies in respect of any other levy, duty or similar amount charged or levied by a PFMA entity which now falls within the amended definition of “public authority” if the entity was registered for VAT before 1 April 2005. This rule applies whether the amount is levied in terms of enabling legislation or not. Examples include levies payable to the Financial Services Board, national or provincial gambling authorities, the Water Research Council and the Civil Aviation Authority.

As public authorities were required to deregister for VAT with effect from 1 April 2005, it follows that the amount previously charged or levied would no longer include VAT at the standard rate.¹⁴ Consequently, vendors who make payment of such levy, duty or similar amount are no longer entitled to deduct input tax thereon unless that entity has been notified to register for VAT.

6.2 Definition of “enterprise” [Proviso (viii)]

The definition of “enterprise” was amended by the insertion of proviso (viii) to exclude a constitutional institution. Constitutional institutions listed in Schedule 1 to the PFMA are treated similar to public authorities in that their activities are not enterprise activities. However, the difference in VAT treatment is that –

- a constitutional institution is not included in the definition of “public authority” in section 1(1); and
- the activities of constitutional institutions are excluded entirely from the definition of “enterprise”. Their activities can therefore never fall within the ambit of the Act, and they may not register for VAT.

Constitutional institutions which were registered before 1 April 2005 were therefore also deregistered from 1 April 2005. Relief from the output tax normally due on this taxable event would have been provided in terms of proviso (iv) to section 8(2). (See 6.7 below.)

6.3 Definition of “designated entity”

A designated entity is a specific kind of vendor, namely –

- a “public authority” which is registered for VAT in terms of paragraph (b)(i) of “enterprise” (only to that extent); or
- a major public entity listed in Schedule 2 to the PFMA; or
- a national government business enterprise or provincial government business enterprise listed in either Part B or D of Schedule 3 to the PFMA; or
- a “Public Private Partnership” (PPP) as defined in the PFMA and the Treasury Regulations; or

¹⁴ This rule applies unless that levy, duty or similar amount is set by any other Act, Regulation or measure having the force of law as a VAT inclusive amount, where that legislation has not been amended with effect from 1 April 2005 to exclude the VAT. It may be found, therefore, that some public entities continued to charge VAT in this regard for a short period of time until a new regulation could be issued to amend the amount payable to exclude VAT.

- a “welfare organisation”; or
- a “municipal entity” (as defined in section 1 of the Local Government: Municipal Systems Act No. 32 of 2000); or
- an entity which has powers similar to those of any water board listed in Part B of Schedule 3 of the PFMA, where that entity would have also complied with the definition of local authority” before the deletion of that definition on 1 July 2006.

These are entities in which government has an interest and may therefore assist them by funding their activities. For example, government may be the majority or sole shareholder, or the entity might be involved in delivering public goods and services. Designated entities are identified as service providers to government to the extent that the payment is in respect of taxable supplies made by them. *(See application of section 8(5) in 6.8 below.)*

As the deeming provision in section 8(5) was amended so that it only applies to designated entities, any payment to a designated entity by a public authority in respect of its enterprise activities is subject to VAT at the standard rate with effect from 1 April 2005. There are two exceptions in this regard, namely, where the designated entity –

- is a welfare organisation – in which case the zero rate in terms of section 11(2)(n) will continue to apply; and
- receives a grant in terms of section 10(1)(f) of the Skills Development Act No. 97 of 1998 for training its employees, that payment is zero-rated [section 11(2)(u)].

6.4 Definition of “grant”

A grant which is paid by a public authority to a private vendor (that is, not being a “designated entity”) will be zero-rated in the hands of the recipient in terms of sections 8(5A) and 11(2)(t).

The current law also allows such payments to qualify for zero-rated VAT treatment, as well as payments made under the DOR Act (mainly affecting municipalities). Before 1 April 2005 the receipt of such payments would not have qualified for the zero rate since they would have been excluded from the definition of “transfer payment”.

The term “grant” which replaced the term “transfer payment” in the Act is split into two main parts as described below.

The first part describes in general terms which type of payments will qualify as a “grant” as follows:

“[M]eans any appropriation, grant in aid, subsidy or contribution transferred, granted or paid to a vendor by a public authority, municipality or constitutional institution... .”

The use of the words “appropriation”, “grant in aid” and “subsidy”, indicate that the receipt constitutes assistance from the state (usually in the form of money). In other words, it is a gratuitous or “unrequited” payment by the grantor, where no reciprocity is expected from the recipient in the form of a supply of goods or services of corresponding value.

Where the recipient is required to perform minor actions in regard to the grant, such as providing the grantor with information on how the funds were spent, or reporting on how goods or services granted were applied, these actions are not regarded as constituting a taxable supply of “services” by the grantee to the grantor in terms of section 7(1)(a). However, if a public authority engages a service provider to supply a specific service in return for the payment, that payment is not a “grant” as defined.

A grant also excludes financial assistance in the form of a loan where, and to the extent, that the amount must be repaid to the lender (grantor) either in the form of money, or in the form of a supply of goods or services.

Sometimes it can be quite difficult to distinguish between a grant and a payment for goods or services supplied, as the perceptions of the parties are not always in alignment when there is no written document which attempts to address the duties and responsibilities of the parties. Even in the case where there is a written document, the parties should be careful not to form an opinion on this point based exclusively on the ordinary meaning of certain words used in the document. For example, if the word “grant” is used to describe the payments to be made in terms of a “grant contract”, the word “grant” might be interpreted to have different meanings, depending on the context of the contract, the deliverables which are required in terms of the contract (if any), and the perceptions of the parties regarding those deliverables. Furthermore, a “grant” is specifically defined for VAT purposes. This defined meaning is therefore more important than the ordinary meaning when determining the VAT consequences of any transaction (supply) which arises in terms of, or as a consequence of, the grant contract. The mere use of the word “grant” in the contract does not necessarily mean that the payments concerned will qualify as such for VAT purposes.¹⁵

Example 5 – Grant vs consideration for the acquisition of services

The Department of Transport (DoT) engages a private research consultant to conduct a market survey on the public perceptions of the introduction of new legislation pertaining to the taxi industry. As the department has directly procured the services of the vendor for its own purposes, the activities involved in conducting the research and presenting the research findings to the department do not constitute a statement of how grant funds were spent. The payment in this regard is therefore consideration for the actual supply of goods or services which is subject to VAT at the standard rate. The payment cannot qualify as a zero-rated “grant”, even if the payments in terms of the contract have been described as grant payments, as the facts show that the DoT commissioned the research work for its own benefit and that the payments made in terms of the contract were not gratuitous or unrequited.

The second part of the definition reads as follows:

“...but does not include—

- (a) a payment made for the supply of any goods or services to that public authority or municipality, **including** ... in accordance with a procurement process prescribed—

¹⁵ Drafters of such contracts should therefore pay careful attention to the words used to describe the different kinds of payments made in terms of the contract. Also, caution should be exercised when using generic or template agreements which might not be appropriate in the circumstances.

(b)”

This part of the definition is essentially a “procurement” test which specifically excludes payment for the actual supply of goods or services acquired by a public authority, municipality or constitutional institution through their usual respective procurement procedures. This refers especially to the capital or operating expenditure incurred by a public authority, municipality, or constitutional institution for its own consumption in conducting their activities. These expense items should fall under the budget headings “*Current payments*” or “*Payments for capital assets*” of that entity.

The use of the word “including” in the statement “...**including** ...in accordance with a procurement procedure...” also recognises the possibility that goods or services may be acquired in circumstances where the prescribed procurement procedures might not apply. In each instance it must be established if the amount was paid in respect of the actual acquisition of any goods or services or not.

It should also be noted that where the grantor pays a supplier of goods or services directly on behalf of the grantee, this does not mean that the supplier may charge the zero rate on the supply made to the grantee. In such cases, the grantee is still deemed to make a zero-rated deemed supply to the grantor in respect of the payment, but the supplier must charge VAT on the actual supply at the standard rate (if it is a taxable supply), and issue a tax invoice to the grantee for purposes of deducting input tax thereon according to the normal VAT rules.

Example 6 – Procurement

- Office supplies paid for out of petty cash where the formal procurement procedure does not apply;
- 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 fixed assets and create intellectual property which becomes the property of the grantor;
- Any other payment which is incorrectly classified by a public authority as a “grant”, where, in substance, the amount represents payment for the actual supply of goods or services which are to be consumed by the public authority making that payment, or for an actual supply to a third party on the instruction of the grantor.

Paragraph (a) of the definition contains two exclusions as follows:

“...but does not include—

(a) ...

- (i) in terms of the Regulations issued under section 76(4)(c) of the Public Finance...; or
- (ii) in terms of Chapter 11 of the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003), **or any other similar process**; or... .”

In the past, national and provincial departments were required to procure goods or services either through the State or Provincial Tender Boards, or in terms of the PFMA. All public entities are now required to procure goods and services in

accordance with the PFMA Regulations. This is essentially covered by the Regulatory Framework for Supply Chain Management (SCM)¹⁶ which applies to all national and provincial departments and trading entities, constitutional institutions and public entities listed in Schedules 3A and 3C to the PFMA. It will also include reference to any deviations which may be allowed from the SCM as a result of the phasing in of those procedures in terms of Treasury Regulation 16A12, or as otherwise required in terms of section 38(1)(j) of the PFMA.

The Municipal Finance Management Act No. 56 of 2003 (MFMA) generally applies to municipalities in the same way that the PFMA applies to public authorities. As the procurement procedure as set out in Chapter 11 of the MFMA was being phased in at the time that the VAT law was amended in 2005 and 2006, those procedures only applied to certain municipalities at the time. Municipalities are now also expected to apply SCM which is supported by, amongst others, Chapter 11 Part 1 of the MFMA, the Municipal SCM Regulations issued in terms of the MFMA, the Municipal SCM Model Policy and other documents such as practice notes and circulars issued by National Treasury in this regard.

The two exclusions in paragraph (a) of the definition of grant” are therefore a reference to the typical manner in which public authorities, public entities and municipalities acquire goods and services, but it is not limited to acquisitions in terms of the approved processes.

The use of the words **“or any other similar process”** in paragraph (a)(ii) of the definition is intended to have a similar effect in the case of municipalities as was explained above with regard to the function of the word “including” in paragraph (a)(i) with reference to procurements by public entities. In both cases the exclusions are intended to make it clear that all methods which involve the actual procurement of goods or services do not fall within the meaning of “grant”, whether the official procurement methods were used or not. This means that any form of *quid pro quo* (consideration) which can be linked to an actual supply of goods or services made to the public authority or municipality which makes the payment, or which has been paid for by that entity on behalf of a third party beneficiary, cannot constitute a “grant” as defined.

It should also be noted that provisions such as section 67 of the MFMA which allow municipalities to make gratuitous payments under certain circumstances, for example, to public benefit organisations, cannot be used as a way of circumventing the definition of “grant”. For example, words such as “grant”, “subsidy”, “grant in aid” or “intergovernmental grant” are sometimes used in a contract to describe payments made to the contracting party to perform activities which have been outsourced by a municipality. Whether the supplies are contractually made to the municipality that makes the payment, or to a third party beneficiary, in either case, the payment is not gratuitous or unrequited and will not meet the definition of “grant”. It follows that it cannot be assumed that a payment which is said to have been made in terms of section 67 of the MFMA is a zero-rated “grant” for VAT purposes merely because it has been called a grant. Each case must be tested to establish whether the recipient

¹⁶The SCM was published in the *Government Gazette* No. 25767 dated 5 December 2003 as Government Notice No. 7837 as part of Treasury Regulations in terms of section 76(4)(c) of the PFMA. New Draft Regulations were also published by National Treasury in terms of section 78 of the PFMA for public comment by 8 February 2013. Refer to GN 1005 published in *Government Gazette* No. 35939 dated 30 November 2012 or to National Treasury’s website www.treasury.gov.za for more information.

is required to supply any goods or services in return for the payment. The same reasoning will apply to any outsourcing arrangement involving a public authority.

Paragraph (b) of the definition contains a further exclusion as follows:

“...but does not include—

- (a) ...
- (b) a payment contemplated in section 8(23); .”

Housing subsidy payments are also excluded from the definition of “grant”. However, these payments qualify for zero-rated VAT treatment under sections 8(23) and 11(2)(s). (*See the application of these provisions in 6.10 and 6.11.3 below.*)

6.5 Definition of “public authority”

As explained in 4.3, the terms “department”, “division of the public service” and “provincial administration” are not defined for VAT purposes, and this introduced some doubt as to the VAT status of other government agencies. As a result of this uncertainty, some constitutional institutions and regulatory, administrative or statutory bodies registered for VAT in terms of paragraph (a) of the definition of “enterprise” as they did not regard themselves as public authorities. On the other hand, some of these entities regarded themselves as public authorities, and as they had not been notified to register as required in terms of paragraph (b)(i) of the definition of “enterprise”, they did not register.

The definition of “public authority” was amended to **include** –

- the entities listed in Parts A & C of Schedule 3 to the PFMA (including any subsidiary or entity under the ownership control of that entity¹⁷); and
- all the national and provincial government departments listed in Schedules 1, 2 or 3 of the PSA (including any branches, divisions, trading accounts, local offices and other components of that department); and
- certain other entities which should be regarded as public authorities. This was introduced primarily to address situations where –
 - newly created public entities are in the process of being classified;
 - entities are re-classified in terms of the PFMA as a result of changes to their functions and mandate from government; and
 - entities disagree with their classification in terms of the PFMA and intend to apply for re-classification (or entities which have already applied to be re-classified).

The definition **does not include** –

- constitutional institutions listed in Schedule 1 to the PFMA;
- national or provincial government business entities listed in Parts B & D of Schedule 3 to the PFMA;
- major public entities listed in Schedule 2 to the PFMA;
- public private partnerships (PPPs);

¹⁷ The wording of the various schedules to the PFMA was subsequently amended so that they now include “all subsidiaries of the above ...”.

- local authorities or municipalities (town councils, TLCs, RSCs, JSBs etc); or
- any institution of higher education.¹⁸

6.6 Definition of “transfer payment”

The definition of “transfer payment” was deleted as well as section 11(2)(p) which was associated with that definition. This was replaced with the definition of “grant” (see 6.4 above) and section 11(2)(t) which was introduced to zero-rate the deemed supply which arises when a vendor receives a grant for taxable (enterprise) purposes. Although the term “grant” includes a wider number of payments than the term “transfer payment”, it is more specific so that it provides a greater degree of certainty in identifying the type of payments which are intended to qualify for zero-rated tax treatment.

6.7 Section 8(2) proviso (iv) – Certain supplies of goods or services deemed to be made or not made upon ceasing to be a vendor

Section 8(2) deems a vendor to supply the assets used for enterprise purposes when ceasing the enterprise. It requires that output tax be declared on the lesser of cost or open market value of those assets at the standard rate. However, proviso (iv) was inserted under section 8(2) to provide relief from the output tax which would otherwise have been payable by constitutional institutions and public authorities upon deregistration.

The application of this provision means that no output tax is payable in terms of section 8(2) upon deregistration where the entity –

- was not a “public authority” before 1 April 2005, but falls within the amended definition after that date (for example, Schedule 3A & 3C PFMA entities); or
- is a constitutional institution listed in Schedule 1 to the PFMA, and from 1 April 2005 is no longer regarded as an “enterprise” for VAT purposes because of the insertion of proviso (viii) to the definition of “enterprise”.

A public authority or constitutional institution which was registered for VAT before 1 April 2005 is therefore not required to declare output tax on the value of assets deemed to be supplied upon deregistration, despite the fact that they may have been allowed to deduct input tax on certain assets acquired during the time that it was registered.

Similarly, the proviso to section 23(4) was also inserted to deal with the liability of those entities which did not register because of the uncertainty regarding the meaning of the term “public authority”, and its effect on the application of paragraph (b)(i) of the definition of “enterprise”. (See discussion under 4.1.1, 4.3, 6.1 and 6.5.)

The relief did not, however, apply where the public authority or constitutional institution applied to register for VAT and was registered during the period 22 December 2003 to 31 March 2005. This exclusion was intended to prevent abuse whereby entities which were registered for VAT during the aforementioned period and deducted input tax on their assets whilst being aware that no output tax would be required upon deregistration. Alternatively, if the person representing that entity was

¹⁸ Refer to section 47(4)(c) of the PFMA. In terms of this provision, institutions of higher education such as universities, universities of technology (previous technikons) or colleges contemplated in the Higher Education Act, 1997 may not be listed in Schedule 3 to the PFMA.

not aware of the new laws, to prevent the entity from inadvertently acquiring a tax benefit or advantage as a result of the application of the amended law.

The relief applied only in the instances where the vendor –

- (i) fell within the amended definition of “public authority”, and was not notified to register in accordance with paragraph (b)(i) of the definition of “enterprise” with effect from 1 April 2005; or
- (ii) was a constitutional institution and as a result of the insertion of proviso (viii) to the definition of “enterprise” with effect from 1 April 2005, its activities were excluded from the definition of “enterprise”; or
- (iii) was a public entity listed in the Schedules to the PFMA, and, as a result of a re-classification under those Schedules on or after 22 December 2003, the entity was classified as a “public authority” or constitutional institution with effect from 1 April 2005 (the implications of which are set out in points 1 and 2 above). Where the re-classification related to only a part of the public authority’s activities, the relief applied only to that extent.

6.8 Section 8(5) – Certain supplies of goods or services deemed to be made or not made upon receipt of a payment from a public authority or municipality by a designated entity

Individual phrases in section 8(5) (as amended) are explained below. The text that was deleted is shown in bracketed bold font and the text that was inserted is shown as underlined.

*“For the purposes of this Act a **[vendor]** designated entity shall be deemed to supply services to any public authority or municipality¹⁹ ...”*

Refer to **4.6** on the application of the law as it read before 1 April 2005 (as those principles are still relevant after 1 April 2005). The effect of replacing the word “vendor” with the term “designated entity”, is that section 8(5) now only applies to designated entities.

As discussed previously, the deemed supply will arise whether the payment is received from a public authority or municipality. Since the definition of “public authority” was expanded to include public entities listed in Parts A & C of Schedule 3 to the PFMA, any payment by such entity to a “designated entity” will also give rise to a deemed supply which is generally subject to VAT at the standard rate. (Refer also to **6.3** above for more details about designated entities.)

“...to the extent of any payment made by the authority concerned...”

Refer to **4.6** on the application of the law as it read before 1 April 2005.

¹⁹ The term “local authority” was only replaced by the term “municipality” with effect from 1 July 2006, but as that amendment does not impact on the discussion in this paragraph, the current wording of the Act is used here. The same will apply for further quotations of the law in **6** and in **Annexure A – Part 2**.

“...to or on behalf of [the vendor] that designated entity in respect of the taxable supply of goods or services by [the vendor to any person] that designated entity;”

See 4.6 on the application of the law as it read before 1 April 2005. The amendment is textual, following on from the fact that this provision applies only to designated entities. The reference to “any person” was deleted as it was deemed superfluous to refer to the recipient of the designated entity’s taxable supplies within the context of the amended wording.

As a result of some further uncertainty which persisted in regard to the application of section 8(5), this part of the provision was subsequently amended²⁰ as follows:

“... to or on behalf of that designated entity in [respect of the taxable supply of goods or services] the course or furtherance of an enterprise carried on by that designated entity.”

The effect of this amendment was to make it clear that the deemed supply which arises in terms of section 8(5) is a taxable supply if the receipt is for taxable use in the enterprise. The uncertainty that this amendment sought to deal with, was the perception that certain receipts did not fall within the ambit of the provision. For example, if a budgeting shortfall on the salaries of a designated entity was topped up by a payment from National Treasury, the amendment made it clear that the receipt was received in the course or furtherance of the enterprise, regardless of the fact that it related to expenses of the enterprise on which no input tax could be deducted. In other words, such a payment to a designated entity for the purposes of its enterprise must include VAT at the standard rate since there is no zero-rating provision in section 11(2) which applies for designated entities in this regard.

6.9 Section 8(5A) – Certain supplies of goods or services deemed to be made or not made upon receipt of a payment from a public authority or municipality by a vendor (not being a “designated entity”)

Individual phrases in section 8(5A), are explained below.

“For the purposes of section 11(2)(t)...”

Unlike section 8(5), which applies for the purposes of the Act as a whole, this provision applies specifically for the purposes of the zero-rating provided for grant payments in terms of section 11(2)(t).

“...a vendor (excluding a designated entity) shall be deemed to supply services to any public authority, municipality or constitutional institution listed...”

Since the amendment to section 8(5) makes that provision applicable exclusively to designated entities, a similar provision was introduced to create a deemed supply where a vendor (not being a designated entity) receives a grant. (See also 4.6 on the application of section 8(5) for the relevant interpretation principles.)

The issue was that under the previous wording of the Act, a “transfer payment” as defined would only qualify for the zero-rate in terms of section 11(2)(p), where the grantor was a “public authority”. However, a similar subsidy or grant payment by a municipality or certain PFMA entities did not qualify for the zero-rating.

Section 8(5A) (through the amended definition of “public authority”), extends the deeming provision relating to grants (and hence the zero-rating provisions under

²⁰ Refer to Revenue Laws Amendment Act (No. 60 of 2008).

section 11(2)(t) to apply in respect of certain payments made by constitutional institutions, municipalities and public entities listed in Parts A & C of Schedule 3 to the PFMA. The purpose of this deeming provision is to bring a grant payment within the scope of the Act so that the zero-rating in terms of section 11(2)(t) can apply. However, the provision does not apply to a “designated entity”, as section 8(5) will apply in that case (see **6.8** above).

Section 8(5A) also includes grant payments made between any of the entities mentioned, for example, a grant from one municipality to another, or from a Schedule 3A PFMA entity to a Schedule 3C PFMA entity. This is to cover the situation where the responsibility to approve and make grants available to the identified beneficiaries is devolved or assigned to another entity.

“...to the extent of any grant paid to or on behalf of that vendor in respect of the taxable supply of goods or services by that vendor.”

The deeming provision only applies where the amount paid to the vendor by the public authority, municipality or constitutional institution is a “grant” as defined. This part of the wording of section 8(5A) as quoted above is the original wording which was inserted on 1 April 2005. Note, however, that a similar amendment to the one mentioned in the last two paragraphs of **6.8** was also made to section 8(5A) to deal with the continued uncertainty regarding certain payments received. The only difference being that the payment referred to in this provision is subject to the zero rate of VAT in terms of section 11(2)(t), as the recipient is not a designated entity. (See also **4.6** on the application of section 8(5) for the relevant interpretation principles, as well as the explanation on the definition of “grant” in **6.4** above.)

A further issue related to the definition of a “grant” and the application of the deeming provisions of section 8(5A) is that compensation paid by a public authority to a vendor (usually a farmer) to supply a “controlled animal or thing” as contemplated in terms of section 19 of the Animal Diseases Act No. 35 of 1984 remained problematic. The reason is that the vendor in such cases is required to actually supply the diseased animals to the public authority. The compensation paid is therefore consideration for an actual taxable supply of **goods** and cannot give rise to a deemed taxable supply of **services** in terms of section 8(5A). The Act was therefore amended on 7 February 2007²¹ to provide for these payments to be subject to the zero rate in terms of section 11(1)(r).

6.10 Section 8(23) – Certain supplies of goods or services deemed to be made or not made upon receipt of a housing subsidy payment by a vendor from a public authority or municipality

Individual phrases in section 8(23) which were inserted, are explained below.

“For the purposes of this Act ...”

This provision applies for the purposes of the Act as a whole.

“...a vendor shall be deemed to supply services to any public authority or municipality...”

Previously, housing subsidy payments were treated as zero-rated transfer payments in terms of section 8(5) and 11(2)(p). As section 8(5) was amended so that it applies exclusively to designated entities, a similar provision in the form of section 8(23) was

²¹ Refer to Revenue Laws Amendment Act No. 20 of 2006.

introduced to create a deemed supply where a vendor (e.g. a property developer or builder), is involved in delivering low cost housing projects and that person receives an amount on behalf of the housing subsidy beneficiary. The purpose of this deeming provision was to bring the housing subsidy payment within the scope of the Act so that the zero-rating in terms of section 11(2)(s) could apply. (See **4.6** on the application of section 8(5) as it read before 1 April 2005 for the interpretation principles.)

“... to the extent of any payment in terms of the Housing Subsidy Scheme referred to in section 3(5)(a) of the Housing Act, 1997 (Act No. 107 of 1997) ...”

The deemed supply only applies in respect of, and to the extent that, the vendor receives payment of the low cost housing subsidy amount to which certain beneficiaries are entitled in terms of the Housing Act. If the housing subsidy is insufficient to cover the price of the house, the additional consideration payable by the beneficiary to the vendor is subject to tax at the standard rate. This would include a case where the developer is a municipality.

“...made to or on behalf of that vendor in respect of the taxable supply of goods and services by that vendor”

This part of the wording of section 8(23) was similar to the wording of sections 8(5) and 8(5A) when the law was amended on 1 April 2005. However, as mentioned in **6.8** and **6.9**, the wording of sections 8(5) and 8(5A) was later amended to refer instead to payments received in the course or furtherance of a vendor’s **enterprise** to deal with some remaining uncertainty regarding certain payments. Section 8(23) was also subject to further amendment²² so that it now refers to a payment made in terms of a national housing programme approved by the Minister by regulation after consultation with the Minister responsible for Human Settlements. The purpose being to narrow the wording to make it clear that the zero-rating only applies to subsidy payments made in terms of certain housing programmes and not to others.

6.11 Section 11(2) – Zero-rating – Services

See **4.7** for an explanation on the application of section 11(2).

6.11.1 Section 11(2)(p) – Zero-rated “transfer payment”

The provision was deleted. (See also **6.4** and **6.6**.)

6.11.2 Section 11(2)(t) – Zero-rated “grant”

“the services are deemed to be supplied in terms of section 8(5A).”

Essentially, this provision will apply where a private vendor (not being a “designated entity”)²³, receives some form of financial assistance from the State or a municipality to enable that person to make taxable supplies. The zero-rating only applies where the amount is a “grant” as defined in section 1(1), and where the deeming provisions of section 8(5A) apply. (See also **6.4** and **6.9** above, particularly where the grantor makes payment on behalf of the grantee directly to a third person.)

The payment must not constitute the procurement of goods or services in terms of section 7(1)(a) by a public authority, constitutional institution or municipality, or be a

²² Refer to the Taxation Laws Amendment Act (No.7 of 2010).

²³ A “welfare organisation” is also a “designated entity”, however, section 11(2)(n) will apply in the case of a welfare organisation and not section 11(2)(t). Refer to **6.11.4**.

housing subsidy payment. (The latter payments being specifically dealt with under sections 8(23) and 11(2)(s).)

6.11.3 Section 11(2)(s) – Zero-rated housing subsidy payment

“the services are deemed to be supplied to a public authority or municipality in terms of section 8(23).”

The situation here is slightly different from the explanation on the application of section 11(2)(t) in 6.11.2 above, as the subsidy beneficiary is generally a private individual (not registered for VAT). Secondly, the amount is normally paid directly to an intermediary (usually a vendor) who will supply the goods and services, and not to the beneficiary. Unlike section 11(2)(t), this provision allows the public authority to make payment for a supply to the third party (the beneficiary) to qualify for the zero rate.

The provision is underpinned by the government policy that low cost housing subsidies should not bear VAT at the standard rate. The zero-rating only applies to the extent that the subsidy amount is used to pay for goods and services which relate to the acquisition of the low cost house itself, or essential services which pertain directly to the transfer of ownership and registration of the property in the beneficiary’s name. The payment of additional consideration to the service provider which is not covered by the housing subsidy amount will result in VAT at the standard rate being charged on that amount. *(Refer also to the explanation in 6.10 relating to the application of section 8(23) which must be read together with section 11(2)(s).)*

6.11.4 Section 11(2)(n) – Zero-rated payments to welfare organisations

The amendment to section 11(2)(n) is purely textual in nature. It was necessary because of the amendment to section 8(5) and the inclusion of a welfare organisation in the definition of “designated entity”. The effect is that although a welfare organisation is a “designated entity”, the zero-rating has been retained for the deemed supply which arises in respect of certain payments received for carrying on taxable welfare activities.

It should, however, be noted that where the constitutional institution, public authority or municipality procures goods or services through that welfare organisation, there may be an actual (standard-rated) taxable supply in terms of section 7(1)(a). Such payments are therefore not zero-rated in terms of this provision. *(See also 6.4 and 6.9, particularly where the grantor makes payment on behalf of the grantee directly to a third person who makes a taxable supply to the grantee.)*

6.11.5 Section 11(2)(u) – Zero-rated SETA training grants paid to designated entities

“the services are deemed to be supplied in terms of section 8(5) by a designated entity in respect of any payment made in terms of section 10(1)(f) of the Skills Development Act, 1998 (Act No. 97 of 1998), to that designated entity.”

The amendments had the unintended effect that SETA grants payable to designated entities did not qualify for the application of the zero rate of VAT, as is the case for other vendors. Designated entities are also liable for SDL payments and are also entitled to receive training grants in terms of section 10(1)(f) of the Skills Development Act, 1998, once they have submitted their workplace training plans to the Department of Labour. The Act was therefore amended further to ensure that SETA training grants paid to designated entities are zero-rated, otherwise it would have created an unfair result.

6.12 Section 18(4) – Change in use adjustments (denial of input tax)

Section 18(4) provides for input tax to be deducted in certain instances where there has been a change in the use or application of goods or services which were originally acquired for exempt, private, or other non-taxable purposes and subsequently applied wholly or partially for taxable use or application. This will apply, for example, where VAT was paid on the acquisition of dwellings used to generate exempt rental income, and subsequently those dwellings are converted into offices or commercial accommodation and rented out as such.

Since the classification of public entities in terms of the PFMA is used as a basis for determining how an entity is treated for VAT purposes, any re-classification of that entity within those Schedules may have a VAT implication. Where an entity is not registered for VAT, as it is classified as a “public authority” or a “constitutional institution”, the re-classification of that entity (or a part of its activities) may result in that entity becoming liable to register. If this occurs, proviso (iv) to section 18(4) will prevent that entity from deducting any input tax on the adjustment which would otherwise have been allowed, for any assets brought into the “enterprise” in respect of which it is now required to register.

Example 7 – Denial of input tax adjustment upon reclassification

If an entity in Schedule 3C of the PFMA (Provincial Public Entity) is re-classified under Schedule 3D of the PFMA (Provincial Government Business Enterprise), it will not be able to make an input tax adjustment on their existing assets which are now applied for taxable purposes as a result of the re-classification.

The terms “re-classified” and “applies” in the context of proviso (iv) to section 18(4), refers to the extent of the change in the taxable status of the entity’s activities as a result of the re-classification in terms of the PFMA (and hence the change in application of certain assets for that purpose). This re-classification may have required the entity to be notified to register to the extent that the supplies are regarded as taxable in terms of paragraph (b)(i) of the definition of “enterprise”. Whether wholly or partially taxable, an input tax adjustment is denied to the extent that the assets are subsequently applied for enterprise purposes as a result of the re-classification.

Example 8 – Denial of input tax adjustment upon transfer of non-enterprise assets to a taxable entity or separate taxable trading account

- Where a Schedule 3A PFMA entity (public authority) transfers assets used for out-of-scope “public authority” activities into a separate “ring-fenced” trading account in order to carry on a taxable business activity in respect of which it has been (or will be) notified to register for VAT in terms of paragraph (b)(i) of the definition of “enterprise”.
- Where a Schedule 3C PFMA entity (public authority) provides funds and/or assets for the purposes of conducting a business activity under a separate legal entity formed (or to be formed) for that purpose. For example, where the entity transfers existing funds or assets originally received for exempt or out-of-scope “public authority” activities to a Schedule 3D PFMA entity (vendor), which it controls, for the purposes of making taxable supplies.

6.13 Section 23(4) proviso – Registration of persons making supplies in the course of enterprises where the public entity should have registered before 1 April 2005

Section 23(4) provides that where any person has applied for registration within the required 21-day period after becoming liable, or otherwise qualifies for voluntary registration, the Commissioner may determine the date that the person shall be a vendor for VAT purposes. A person who is required to register for VAT and did not apply within the 21-day period allowed is regarded as a vendor from the date that they were first liable to register. However, having regard to what is considered equitable in the circumstances of the case, the Commissioner may determine a later liability date for that person.

As from 1 April 2005 all public entities listed in Schedule 1 and most of the entities listed in Part A or C of Schedule 3 to the PFMA, which were registered as vendors before that date were required to deregister. Only in very limited circumstances were these entities required to register as vendors or remain on the VAT register if they had already registered.

The proviso to section 23(4) provides that with effect from 1 April 2005, the Commissioner may not register such public entity in respect of any enterprise activities carried on before 1 April 2005. By preventing the Commissioner from registering the public entities concerned, those entities were, in effect, not held liable for the output tax which would otherwise have been payable, nor were they entitled to deduct any input tax incurred in respect of any period before 1 April 2005.

The intended effect of this amendment was that public entities who failed to register before 1 April 2005 were not required or permitted to register for the VAT on their past transactions, as they would have subsequently had to deregister as a result of amendments to the law with effect from 1 April 2005. This applied whether the public entity concerned was liable to register, or if it could have registered voluntarily. The reason for this was that these entities have always been funded largely by government and if there were unbudgeted flows of funds to these entities, their allocations of funds would have to be adjusted.

6.14 Section 40A – Liability of public authorities and certain public entities for tax and limitation of refunds

Section 40A deals with the issues pertaining to the recovery of tax from any public entity listed in Schedules 1, 3A or 3C of the PFMA where that entity was registered for VAT by the Commissioner in respect of any period before 1 April 2005. The section basically provided that where certain payments from government were treated incorrectly for VAT purposes before 1 April 2005, the tax would not be recoverable or refundable (as the case may be). Further, that where an assessment had been raised and not yet paid in respect of such amounts, application could be made to reduce the assessment. The provision is analysed and discussed in detail below.

“(1) This section applies in respect of the supply of goods or services on or before 31 March 2005 by any public authority or public entity listed in Schedule 1 or Part A or C of Schedule 3 to the Public Finance Management Act, 1999 (Act No. 1 of 1999).”

Sub-section (1) sets the framework for the scope of application of sub-sections (2) to (4). The provision was necessary so that the VAT consequences of the incorrect treatment of certain payments for supplies made by public authorities and certain public entities before 1 April 2005 could be dealt with. As with some of the other amendments, the underlying reason for the provision is to reduce the circular flow of funds within government departments and various government agencies.

To qualify for the relief provided in this section, the supplier had to be a “public authority” or a constitutional institution listed in Schedule 1 to the PFMA, or a national or provincial public entity listed in Part A or C of Schedule 3 to the PFMA before 1 April 2005. The entity had to have an existing or potential liability for VAT at the time in accordance with the specific conditions contained in sub-paragraphs (2) to (4), which are discussed below.

“(2) Where the Commissioner on or before 31 March 2005 issued an assessment ... contemplated in subsection (1), to correct a prior incorrect application of the zero per cent rate of tax in terms of section 11(2)(p) in respect of that supply, ...”

The first part of sub-section (2) deals with the situation where on or before 31 March 2005 the Commissioner had raised an assessment for the VAT which should have been charged by the vendor at the standard rate in terms of section 7(1)(a) on a payment for a taxable supply, but instead, the vendor incorrectly applied the zero rate in terms of sections 8(5) and 11(2)(p), on the assumption that the payment was a “transfer payment” as defined in section 1 as it read at the time.

“(2) ...the Commissioner must, on written application, reduce that assessment...”

Any public entity or public authority which had an assessment to pay VAT as contemplated in sub-section (1) was allowed to apply in writing to the Commissioner to reduce the assessment for the tax period concerned. Provided all the conditions in the section were met, the Commissioner was required to reduce the assessment accordingly.

“(2) ... to the extent that the amount of tax, additional tax or penalty arose as a result of that correction and was not yet paid on that date.”

The specific liability which could be reduced, was the total amount of tax, additional tax, penalty or interest which had arisen directly as a result of any assessment issued in respect of the supplies referred to in sections 40A(1) and (2), which were incorrectly regarded as being in respect of a zero-rated “transfer payment”. For example, the reduced assessment would not apply where –

- the VAT declared on the VAT 201 was merely not paid, or was paid late; or
- there was a failure to submit a return and as a result, an estimated assessment was issued in respect of that tax period; or
- an assessment was issued because output tax was under-declared for any reason other than the one mentioned in section 40A(2), or if the input tax was overstated in respect of any tax period.

The relief applied only to the net balance of any tax, additional tax, penalty or interest as at 31 March 2005 which remained payable in respect of the incorrectly treated payments referred to in sections 40A(1) and 40A(2). It did not apply to any amount assessed in this regard which had already been paid or otherwise recovered by SARS. This includes debt which was set off (or which could have been set off) against refund credits arising in another tax period.

“(2) ... Provided that the reduced assessment will not result in a refund to that public authority or public entity”.

The application of the reduced assessment may not have the effect that the public authority or public entity obtains a refund of any tax (including additional tax, or any amount allocated to penalty or interest) for any period before 1 April 2005 to which the assessment relates.

Where a part of, or the entire debt had been paid or otherwise recovered by SARS, that amount was not added back before calculating the amount of the reduced assessment. This is because the proviso to this section clearly states that the application of this provision may not result in a refund to that public authority or public entity. This means that the balance of existing credits in any other tax periods had to first be transferred to the tax period in which the debt existed so that it reduced the outstanding debt, before applying section 40A(2).

This applied as follows:

- Vendors registered on Category A or C tax period – existing credits, and credits arising in any tax period ending on or before 31 March 2005; and
- Vendors registered on Category B, D or E tax period – existing credits, and credits arising in any tax period ending on or before 28 February 2005, plus any credits arising between the end of that tax period and 31 March 2005. [For example, the last tax period for a vendor on Category B was from the beginning of March 2005 to the end of April 2005. Credits arising from transactions with a time of supply between 1 March 2005 and 31 March 2005 in the last tax period had to be offset against the debt in this case before calculating the amount by which the assessment was to be reduced in terms of section 40A(2)]. (See *Example 12 in Annexure D.*)

“(3) The Commissioner may not after 31 March 2005 make any assessment to correct a previous incorrect application of the zero per cent rate of tax in terms of section 11(2)(p) in respect of any supply of goods or services contemplated in subsection (1).”

This provision applies to the same incorrectly treated payments as contemplated in sub-section (2). However, under this sub-section, there would have been no assessment by SARS for the tax liability concerned, which would otherwise have been recoverable from the public authority or public entity (whether registered as a vendor or not). Under subsection (3), SARS may no longer raise an assessment in respect of the tax liability pertaining to those incorrectly treated payments with effect from 1 April 2005. This means that an assessment could only be raised by SARS on or after 1 April 2005 to recover the VAT payable on taxable supplies before 1 April 2005 in circumstances **other than** those covered by this provision. For example, an assessment could have been raised by SARS where –

- there was a failure to submit a return and as a result, an estimated assessment was issued in respect of that tax period;

- the amount due was not connected to any dispute regarding a transfer payment; or
- an assessment was issued in respect of any tax period where the output tax was under-declared (other than in the specific circumstances provided for in section 40A(1)), or the input tax was overstated.

“(4) If a public authority or public entity incorrectly charged tax at the rate referred to in section 7(1)(a) instead of the zero per cent rate of tax in terms of section 11(2)(p) in respect of any supply contemplated in subsection (1), the Commissioner may not refund any such tax or any penalty or interest that arose as a result of the late payment of such tax, paid by that public authority or public entity to the Commissioner.”

This provision deals with the situation where the public authority or public entity incorrectly treated a “transfer payment” as consideration for a taxable supply and paid output tax to SARS at the standard rate in terms of section 7(1)(a) instead of at the zero rate in terms of sections 8(5) and 11(2)(p). In such cases, section 40A(4) would override sections 44(2) and (3) (which deal with refunds), so that the public authority or public entity was not able to claim a refund of the output tax which it may have considered as being overpaid.

Example 9 – Application of the relief in section 40A

A Schedule 3A public entity (registered for VAT before 1 April 2005) submitted a refund return for R50 000 for the October 2004 tax period. In the meantime, the SARS auditors raised an assessment for R60 000 in respect of a payment for services in the tax period ending December 2003 which the vendor had treated incorrectly as a zero-rated “transfer payment”. Assuming that the amount of R40 000 was the correct refund amount for the October 2004 period, that amount must first be applied to reduce the tax, penalty and interest incurred in the December 2003 tax period. The vendor would have been able to apply for the assessment for the December 2003 tax period to be reduced by the amount of the unpaid tax, penalty and interest which remained after having set off the R40 000 credit [section 40A(2)]. SARS could not reduce the December 2003 tax period assessment to nil, plus refund the R40 000 for the October 2004, since this would have resulted in an incorrect application of the law and an incorrect refund to the vendor [section 40A(4)].

For further examples of the application of the provisions contained in this Note, refer to **Annexure D**.

Note that section 40B was later introduced to deal with payments received in respect of the DOR Act, the wording of which is similar to section 40A, and is mostly applicable in the case of municipalities. For more information on section 40B, refer to the *VAT 419: Guide for Municipalities* which is available on the SARS website.

7. Practical implications

The implementation of the changes to the law dealt with in this Note gave rise to the following practical issues:

7.1 New registrations

Certain public authorities were notified by SARS that they should be registered for all or some of their activities in terms of paragraph (b)(i) of the definition of “enterprise”,

after receiving the decision of the Minister in this regard. In addition, if a public authority is not notified as stated above, it may nevertheless make an application to register. The details of the case and the public authority's reasons for wanting to register must be clearly motivated in a written application headed "Application for a VAT Ruling" and sent by email to **VATRulings@sars.gov.za** or facsimile on +27 86 540 9390.

After considering the merits of the case in consultation with National Treasury, and with reference to the requirements of the PFMA, that entity will be notified whether or not it may register for VAT after a decision to that effect has been made by the Minister. *Refer to 6.13 and 7.6 for further details.*

7.2 Budgeting

On the expenditure side of the budget, public authorities which were required to deregister for VAT with effect from 1 April 2005 had to ensure that when they prepared their budgets, they were calculated on the basis that the VAT incurred on capital and operational expenditure is a cost which could not be deducted as input tax. When the budgeted amount was paid to the public authority, it would not include any output tax to be declared to SARS unless it was a "designated entity" liable to register for VAT (in which case it will pay output tax to that extent). On the income side of the budget, the setting of prices, levies etc had to be revised to take account of the fact that any amounts charged or levied could no longer include VAT with effect from 1 April 2005.

7.3 Procurement of goods and services vs "unrequited" grant payments

Public authorities, municipalities, constitutional institutions and SARS officials must ensure that they understand the difference in the tax treatment between the payment of a grant (0% VAT in the hands of the recipient), and the payment of consideration for a taxable supply (14% VAT payable by the supplier). Vendors who receive payments from departments, public entities or municipalities should ensure that they are informed quite clearly in terms of their contract or other payment advice, whether the amount constitutes a "grant" (gratuitous or "unrequited" payment), or if it is consideration for a taxable supply of goods or services procured, or otherwise acquired by that entity for their own consumption, or for supply to a third person. By having a clear understanding of the nature of the payment received, the correct tax treatment can be determined and applied. This will avoid the vendor having to seek a ruling on the correct VAT treatment of the payment received and also having to negotiate an increase in the amount paid should there be a budgeting shortfall as a result of this miscalculation.

7.4 Procurement and accounting accruals

Inherent administration and accounting delays in the procurement and payment process (e.g. delays in receiving and capturing billing information and/or following up on tax invoices not yet received etc) led to a position where many of the public authorities which were required to deregister could not immediately and accurately determine their final position for VAT purposes as at 31 March 2005. To overcome this problem, a period of six months was allowed (up to 30 September 2005) for those entities to conduct the necessary internal audit procedures, make the final adjustments, and to submit this information to SARS. Refer to VAT News No. 25 and 26 for more details in this regard.

This was purely an administrative arrangement to ensure that the public entities concerned were provided with sufficient time to clear their accounting and administrative systems, relating to any supplies made or received before 1 April 2005 which had not been included on a VAT 201 return because of accounting or administration system “lag factors”.

The following should also be noted in this regard:

- (a) Public authorities were not required to apply for this dispensation. It was automatically applied to all the public entities affected by the changes in the law.
- (b) The final VAT return still had to be submitted by the due date, based on the information available at the end of the relevant tax period.
- (c) The final adjustments are processed separately by SARS once they have been submitted as required, after the 6 months transition period.

This administrative arrangement did not mean that the entities concerned would be able to continue to be VAT vendors and account for the VAT on supplies occurring on or after 1 April 2005. However, there were two cases which required special attention, namely:

- SDL and other duties, levies, or similar charges by statutory, regulatory or administrative public authorities. (See 7.8 and 7.9 for details.)
- Payments basis of accounting – where entities were registered on the payments basis of accounting and they paid certain expenses on or after 1 April 2005 (for which tax invoices were held) for supplies which had a time of supply before 1 April 2005, no input tax could be deducted in that regard. Similarly, where a debtor paid an amount to the public authority (vendor) on or after 1 April 2005, in respect of taxable supplies which it made before 1 April 2005 that public authority was not required to declare output tax thereon. This is because for the purposes of applying the output tax relief in terms of proviso (iv) to section 8(2), the vendor would first be converted to the invoice basis of accounting and the balance of debtors and creditors as at 31 March 2005 would have been set off against each other. Hence, any debtors or creditors payments made to or by that public authority on or after 1 April 2005 in respect of supplies before that date, would have already been taken into account.

7.5 Outstanding VAT returns, payments, assessments and queries

The VAT files of the vendors affected by the amendments were placed into suspense mode until all outstanding VAT 201 returns and payments were submitted, final adjustments had been submitted, and all other queries regarding assessments and other administrative matters were resolved. Whilst in suspense mode, no further VAT 201 returns were issued.

On page 31 of the 2005/6 Budget Tax Proposals booklet issued by SARS, the following was stated in this regard:

“Public authorities/entities: SARS raised assessments against many public authorities and entities due to ongoing confusion about the VAT implications of transfer payments. In 2003 and 2004, Government introduced a whole new set of VAT legislation to eliminate this confusion. In order to bring full finality to this matter,

Government will write off outstanding assessments raised against public authorities and entities to the extent these assessments stem from this longstanding confusion.”

Any dispute regarding an assessment in respect of payments which were apparently treated as zero-rated transfer payments in terms of sections 8(5) and 11(2)(p), should therefore have been resolved in the light of the explanations and interpretations put forward in this note.

Where it was established that the amount owing was in fact properly payable because the payment was incorrectly treated as a zero-rated “transfer payment” instead of a standard-rated payment in terms of section 7(1)(a), the vendor was allowed to apply in writing to SARS for the assessment to be reduced to the extent that the conditions in terms of section 40A were applicable. (See **6.14** for details.)

7.6 “Ring-fencing” of trading activities

Public authorities, as a general rule, are not able to register for VAT unless they are notified as required in paragraph (b)(i) of the definition of “enterprise”. Any decision to register a public authority that comes forward to request that their trading activities should be regarded as taxable is determined as set out in **7.1**.

In order for a public authority to qualify as an “enterprise”, the activity which is sought to be treated as taxable must be “ring-fenced” and moved out of mainstream non-enterprise activities of that department or Schedule 3A or 3C PFMA entity, and conducted under a separate legal entity (unless all of the activities conducted by that public authority are regarded as taxable).

Alternatively, where it is not possible to conduct the taxable activities under a separate legal entity due to other rules and regulations with which that public authority must comply, the taxable activity must be “ring-fenced” and conducted under a separate trading account, branch or division of that public authority. The separate entity or taxable trading account, branch or division must then be notified to register or apply for registration as mentioned in **7.1**. Any transfer of funds or assets from the main public authority (non-vendor) to its taxable trading account or deemed Schedule 3B or 3D “designated entity” (vendor) will have the following VAT implications:

- (i) *Transfer of funds* – Output tax must be declared by the recipient as the amount constitutes consideration for a taxable supply (section 8(5)). When the taxable trading account or deemed Schedule 3B or 3D designated entity incurs VAT inclusive expenses, it is allowed to deduct input tax thereon to the extent that it makes taxable supplies if it meets all the other requirements for deducting input tax (e.g. sections 16(2), 16(3), 17(1), 20, etc).
- (ii) *Transfer of existing assets and other goods and services held before 1 April 2005* – No input tax adjustment is allowed to the separate taxable trading account or deemed Schedule 3B or 3D designated entity when it receives those goods or services for taxable application in the enterprise. (Section 18(4) proviso (iv).) If the transaction occurs on or after 1 April 2005, the main public authority must not declare output tax thereon, as it will no longer be a vendor. Where the transfer occurred before 1 April 2005, the transfer of the asset would have been regarded as consideration for a taxable supply of services by the recipient (barter transaction), and input tax and

output tax on that transaction must be accounted for by the parties respectively.

- (iii) *Purchase and transfer of goods or services acquired on or after 1 April 2005* – If the main public authority acquires goods or services on or after 1 April 2005 on its budget (as principal) and these are subsequently transferred to its separate taxable trading account or deemed Schedule 3B or 3D designated entity, neither the main public authority (non-vendor), nor the recipient is able to deduct input tax thereon (Section 18(4) proviso (iv).)
- (iv) *Subsequent sale of goods or services where input tax was denied in terms of Section 18(4) proviso (iv)* – Where goods or services were acquired as discussed in (ii) and (iii) above, and those things are subsequently supplied in the course of an enterprise by that separate taxable trading account or deemed Schedule 3B or 3D designated entity, output tax must be charged at the standard rate. No input tax is allowed in terms of section 16(3)(h) in respect of that subsequent supply.

7.7 Classification of new entities and re-classification of existing entities in terms of the PFMA

The VAT treatment of new public entities which were in the process of being classified and existing public entities which were re-classified in terms of the PFMA as at 1 April 2005 were decided upon by National Treasury in consultation with SARS, based upon the policy principles discussed in this document as well as the circumstances of the particular case and similar cases encountered. This approach is also followed for any current re-classification cases.

The possible VAT consequences of the transfer of funds or assets from public authorities to newly created entities or to separate trading accounts, as set out in 7.6 above should be noted in this regard.

7.8 SETA grants & SDL payments

The amendments ensured that SETA grants received and SDL payments made by vendors on or after 1 April 2005 were treated on a tax-neutral basis. The effect is that input tax on SDL payments made by vendors can no longer be deducted for any SDL tax period ending after March 2005 (the last payment being due for that period on 7 April 2005). Vendors were allowed to deduct input tax in respect of any arrear SDL payments for SDL tax periods ending no later than 31 March 2005, if that arrear amount was paid on or before 7 April 2005.

The National Skills Fund and SETAs were not able to deduct input tax on training grants paid to vendors on or after 1 April 2005, since they are no longer vendors and did not account for supplies on or after 1 April 2005.

No output tax must be declared by a vendor (including a “designated entity”) on any SETA training grants received on or after 1 April 2005, as the zero rate in terms of sections 11(2)(f) or 11(2)(u) will apply (as the case may be).

7.9 Duties, levies and similar charges by regulatory, statutory or administrative authorities

Where any levy, duty or similar charge was paid to any statutory, regulatory, administrative, or other authority (being a “public authority” on or after 1 April 2005), which was registered for VAT before 1 April 2005, that payment did not include VAT.

This was because the public authority concerned was required to deregister for VAT in terms of the amended law, as explained in 7.8. These entities would therefore not have accounted for the VAT on any supplies which occurred on or after 1 April 2005. Consequently, vendors were not able to deduct input tax on those payments if they were in respect of any period ending after March 2005.

Vendors were allowed to deduct input tax in respect of any arrear payments which included VAT at the standard rate for periods ending no later than 31 March 2005 subject to the normal tax invoice requirements, and provided that the arrear amount was paid on or before the due date for the last payment of any such levy, duty or similar charge.

7.10 Foreign donor funded projects

As a general rule, a “public authority” is not liable or entitled to register for VAT unless it is notified to that effect as contemplated in 7.1, 7.6 or 7.7 above. However, some public authorities are involved in implementing certain projects for the general upliftment of South Africa and its citizens. These projects are funded in terms of international agreements between the South African government and foreign governments, or other International Development Agencies (IDAs) such as the European Union, the United Nations, the World Bank, USAID, DFID etc Foreign governments and IDAs normally provide that the funds donated should only be used for specific and mutually agreed upon programmes and activities and cannot be utilised for any taxes imposed under South African Law (for example, VAT).

The question which arises in this regard is whether a public authority may register as a VAT vendor in order to deduct the VAT charged on goods or services acquired in terms of the requirements of the contract concerned.

Sections 8(5B) and 11(2)(g) provide a dispensation in terms of which a person (including a public authority) will be allowed to zero rate the deemed supply which arises in respect of the receipt of such foreign donor funds. The entity will be allowed to register for VAT to that extent and may deduct input tax on goods or services acquired at the standard rate for the project, where payment has been made out of the donor funds allocated for the project concerned. This allows the tax neutrality required in terms of the international agreement to be achieved. Any such registration should not be confused with a liability to register for taxable supplies as contemplated in 7.1, 7.6 or 7.7.

Where public authorities have been permitted to register for VAT in respect of approved foreign donor projects, the input tax deductions are limited to the VAT incurred on goods or services acquired which are directly in connection with the implementation of the internationally funded project. It does not entitle the public authority concerned to deduct input tax on its normal VAT inclusive capital and operating costs (unless that entity has also been notified to register for taxable supplies as set out in 7.1, 7.6 or 7.7 above – and then, only to that extent).

Where a public authority is allowed to register in this regard, the words “(international donor funded project)” must follow the trading name on the application form so that the VAT file and registration particulars on the system can be noted accordingly.

8. Summary

8.1 Before 1 April 2005

- The definition of “public authority” was not clear. It included only the national and provincial government departments, and branches and components thereof, but not the public entities (government agencies) as listed in any of the Schedules to the PFMA.
- Public entities (including the non-business orientated entities listed in Schedules 1, 3A and 3C to the PFMA), fell within paragraph (a) of the definition of “enterprise” before 1 April 2005 and were liable to register if their taxable supplies exceeded the threshold of R300 000 which was applicable at the time in terms of section 23(1).
- Government departments which registered separate trading accounts for VAT without being notified as required in terms of paragraph (b)(i) of the definition of “enterprise”, were treated as normal enterprises in terms of paragraph (a) of that definition up until 31 March 2005.
- The definition of a “transfer payment” was unclear. This led to inconsistent application of the law. To qualify for the zero-rating in terms of section 11(2)(p), there must have been a deemed supply in terms of section 8(5) where the payment was “unrequited”. The payment could not be in respect of an actual supply of goods or services to the public authority or constitute payment for a specific supply to a third person in terms of section 7(1)(a).
- A deemed supply arose in terms of section 8(5) where an unrequited payment originated from a municipality (or “local authority” as defined at the time) but, as the amount paid was not a “transfer payment” (as defined at the time), the zero-rating in terms of section 11(2)(p) could not apply.
- Appropriations in terms of the DOR Act did not comply with the definition of a “transfer payment” and were not zero-rated.

8.2 On or after 1 April 2005

- The definition of “public authority” was amended to include all the government departments listed in Schedules 1, 2 and 3 of the PSA, as well as the public entities listed in Schedules 3A and 3C of the PFMA. The term excludes constitutional institutions and business orientated public entities (listed in Schedules 1, 2, 3B and 3D of the PFMA).
- PFMA entities listed in Schedules 1, 3A and 3C which registered for VAT before 1 April 2005, were required to deregister for VAT (unless they were notified as required in terms of paragraph (b)(i) of the definition of “enterprise”). Relief from the output tax which would otherwise have been payable upon deregistration in terms of section 8(2) was provided to these entities. [Proviso (iv) to section 8(2).]
- SARS may not retrospectively register any public entity listed in Schedules 1, 3A and 3C of the PFMA which failed to register before 1 April 2005. Such entities were therefore not liable to account for any output tax, nor could they claim any refund in respect of any period before 1 April 2005. [Proviso to section 23(4).]

- If a public authority or any public entity listed in Schedules 1, 3A or 3C of the PFMA registered for VAT before 1 April 2005 and incorrectly treated a payment as a zero-rated “transfer payment” before that date and was assessed for that liability, that entity could apply for the assessment to be reduced accordingly. Where no assessment had been raised in that regard, SARS was prevented from raising an assessment in respect of those incorrectly treated payments. [Sections 40A(2) and (3).]
- The definition of “transfer payment” as well section 11(2)(p) that zero-rated the receipt of those payments were both deleted. The definition of “transfer payment” was replaced with the definition of “grant” to provide more certainty as to which payments (appropriations or subsidies) from government qualify for zero-rated tax treatment.
- Grants to vendors (other than designated entities) are zero-rated in terms of sections 8(5A) and 11(2)(t). This includes a gratuitous payment by a municipality to a private vendor (other than a designated entity, which is not a welfare organisation) provided the payment is truly gratuitous as contemplated in section 67 of the MFMA and has not been incorrectly classified as such. Examples of designated entities are business entities listed in Schedules 2, 3B and 3D of the PFMA, entities listed in Schedules 3A and 3C of the PFMA that have been notified to register by the Commissioner, and municipal entities.
- Low cost housing subsidy payments are now zero-rated in terms of sections 8(23) and 11(2)(s).
- An appropriation in terms of the DOR Act such as a “Municipal Infrastructure Grant” or “equitable share” also qualifies as a zero-rated “grant”, unless the recipient is a “designated entity” (not being a welfare organisation).
- A “grant” excludes procurement and other methods of acquiring goods and services by constitutional institutions, public authorities and municipalities (i.e. the payment must not constitute consideration paid in respect of the actual supply of goods or services in terms of section 7(1)(a) to the entity making the payment, or for a specific taxable supply by the recipient to a third party).
- Section 8(5) was amended so that it now only applies to a “designated entity”. Payments made to designated entities, which are for enterprise purposes, generally attract VAT at the standard rate.
- Designated entities may only zero rate payments from constitutional institutions, public authorities or municipalities when –
 - the amount is a grant for training employees (SETA grants received), or
 - the recipient is a “welfare organisation” and the funds are for the purposes of carrying out “welfare activities”.

Annexure A – Wording of certain provisions in the VAT Act

PART 1 – Wording before 1 April 2005

Section 1 - Definitions

Enterprise [Paragraphs (b)(i) and (c)]

“Enterprise” means—

- (a) in the case of any vendor other than a local authority, ...
- (b) without limiting the applicability of paragraph (a) in respect of any activity carried on in the form of a commercial, financial, industrial, mining, farming, fishing or professional concern—
 - (i) the making of supplies by any public authority of goods or services which the Minister, having regard to the circumstances of the case, is satisfied are of the same kind or are similar to taxable supplies of goods or services which are or might be made by any person other than such public authority in the course or furtherance of any enterprise, if the Commissioner, in pursuance of a decision of the Minister under this subparagraph, has notified such public authority that its supplies of such goods or services are to be treated as supplies made in the course or furtherance of an enterprise;
 - (ii) ...
 - (iii) ...
- (c) in the case of a vendor which is a local authority, any activity in the course or furtherance of which any of the following supplies of goods or services are made:
 - (i) The supply of electricity, gas or water;
 - (ii) the supply of services consisting of the drainage, removal or disposal of sewage or garbage;
 - (iii) the supply of goods or services incidental to or necessary for ... subparagraph (i) or (ii) apply;
 - (iv) the making of supplies of goods or services in the course of any business carried on by such local authority, if—
 - (aa) such supplies are of the same kind or are similar ... made by any person other than such local authority ...; and
 - (bb) the revenue normally derived ..., together with any grant or subsidy ..., sufficient to fund the expenditure ... incurred by that local authority in the production of such revenue; and
 - (cc) (A) such business falls within a category of businesses which the Minister, having regard to the provisions of items (aa) and (bb) as generally applicable, has by notice in the Gazette determined to be a category of businesses in respect of which the provisions of this subparagraph shall be deemed to apply; or
 - (B) such business (not being a business falling within a category referred to in subitem (A)) is determined by the Minister, having regard to the provisions of items (aa) and (bb) as applicable in the case of such business, to be a business in respect of which the provisions of this subparagraph shall be deemed to apply and the Commissioner, in pursuance of the Minister’s determination under this subitem, has notified such local authority accordingly,

and, in the case of a regional services council, a joint services board or a transitional metropolitan council, any other activities of that council or board to the extent that they are financed by levies referred to in section 8(6)(b).

Note: Paragraph (c) of the definition of “enterprise” was subsequently deleted with effect from 1 July 2006.

Local authority

“Local authority” means—

- (a) any divisional council, rural council, municipal council, regional services council, town board, local board, village management board or health committee or any joint services board established under the KwaZulu and Natal Joint Services Act, 1990 (Act No. 84 of 1990);
- (b) any other body, council, board, committee or institution established or deemed to be established by or under any law which has functions similar to those of the councils, boards and committees enumerated in paragraph (a) and which may levy rates on the value of immovable property within its area of jurisdiction or receive payments for services rendered or to be rendered; and
- (c) any water board or regional water services corporation or any other institution which has powers similar to those of any such boards or corporations:

Provided that where any local authority has been disestablished and superseded by a new local authority in terms of the Local Government: Municipal Structures Act, 1998 (Act No. 117 of 1998), such disestablished local authority and such new local authority shall for the purposes of this Act be deemed to be and to have been one and the same local authority.

Note: The definition was subsequently deleted and replaced with the definition of a “municipality” with effect from 1 July 2006.

Public authority

“Public authority” means any department or division of the public service (including a provincial administration, the South African National Defence Force, the South African Police Service and Correctional Services).

Note: The definition was amended on 1 April 2005 to be more specific by including reference to the departments listed in the PSA and certain public entities listed in the PFMA.

Services

“Services” means 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”.

Transfer payment

“Transfer payment” means a transfer payment as contemplated in regulation 8.4 of the Treasury Regulations published in terms of the Public Finance Management Act, 1999 (Act No. 1 of 1999).

Note: The definition was deleted on 1 April 2005 together with the zero-rating for transfer payments in terms of section 11(2)(p).

Section 8 – Certain supplies of goods or services deemed to be made or not made**Section 8(5)**

(5) For the purposes of this Act a vendor shall be deemed to supply services to any public authority or local authority to the extent of any payment made by the authority concerned to or on behalf of the vendor in respect of the taxable supply of goods or services by the vendor to any person.

Note: The definition was amended on 1 April 2005 so that it would only apply to designated entities on or after that date.

Section 11(2) – Zero-rating of services**Section 11(2)(p)**

(2) 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—

...

(p) the services are in terms of section 8(5) deemed to be supplied to a public authority to the extent that the payment contemplated in that section consists of a transfer payment; or

...

Note: This provision was deleted on 1 April 2005 together with the definition of “transfer payment” to which it related.

PART 2 – Wording on or after 1 April 2005

Section 1(1) – Definitions

Enterprise

- Paragraph (b)(i)

“Enterprise” means—

- (a)...
- (b) without limiting the applicability of paragraph (a) in respect of any activity carried on in the form of a commercial, financial, industrial, mining, farming, fishing or professional concern—
 - (i) the making of supplies by any public authority of goods or services which the Minister, having regard to the circumstances of the case, is satisfied are of the same kind or are similar to taxable supplies of goods or services which are or might be made by any person other than such public authority in the course or furtherance of any enterprise, if the Commissioner, in pursuance of a decision of the Minister under this subparagraph, has notified such public authority that its supplies of such goods or services are to be treated as supplies made in the course or furtherance of an enterprise.

- Proviso (viii)

The definition of “enterprise” was amended by the insertion of proviso (viii) to exclude a constitutional institution.

...

Provided that—

...

- (vii) the making of supplies by a constitutional institution listed in Schedule 1 of the Public Finance Management Act, 1999 (Act 1 of 1999), shall be deemed not to be the carrying on of an enterprise.

Designated entity

The definition of a “designated entity” was inserted to provide for all entities in which government has an interest which carry on enterprises, and to provide for welfare organisations.

“Designated entity” means a vendor—

- (i) to the extent that its supplies of goods and services of an activity carried on by that vendor are in terms of (b)(i) of the definition of ‘enterprise’ treated as supplies made in the course or furtherance of an enterprise;
- (ii) which is a major public entity, national government business enterprise or provincial government business enterprise listed in Schedule 2 or Part B or D of Schedule 3 of the Public Finance Management Act, 1999 (Act No.1 of 1999), respectively; or
- (iii) which is a party to a ‘Public Private Partnership Agreement’ as defined in Regulation 16 of the Treasury Regulations issued in terms of section 76 of the Public Finance Management Act, 1999 (Act No. 1 of 1999): or;
- (iv) which is a welfare organisation; or
- (v) which is a municipal entity as defined in section 1 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000);or

- (vi) which has powers similar to those of any water board listed in Part B of Schedule 3 of the Public Finance Management Act, 1999 (Act No. 1 of 1999), which would have complied with the definition of 'local authority' in section 1 prior to the deletion of that definition on 1 July 2006;

Grant

The definition of a "grant" was inserted to provide a greater degree of certainty in identifying the type of payments which are intended to qualify for zero-rated tax treatment.

"grant" means any appropriation, grant in aid, subsidy or contribution transferred, granted or paid to a vendor by a public authority, [local authority] municipality or constitutional institution listed in Schedule 1 to the Public Finance Management Act, 1999 (Act No. 1 of 1999), but does not include—

- (a) a payment made for the supply of any goods or services to that public authority or [local authority] municipality, including all goods or services supplied to a public authority, [local authority] municipality or constitutional institution listed in Schedule 1 to the Public Finance Management Act, 1999 (Act No. 1 of 1999) in accordance with a procurement process prescribed—
 - (i) in terms of the Regulations issued under section 76(4)(c) of the Public Finance Management Act, 1999 (Act No. 1 of 1999); or
 - (ii) in terms of Chapter 11 of the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003), or any other similar process; or
- (b) a payment contemplated in section 8(23).

Public authority

The definition of "public authority" was amended to be more specific by including reference to the departments listed in the PSA and certain public entities listed in the PFMA.

"public authority" means—

- (i) any department or division of the public service as listed in Schedules 1, 2 or 3 of the Public Service Act, 1994 (Act No. 103 of 1994); or
- (ii) any public entity listed in Part A or C of Schedule 3 to the Public Finance Management Act, 1999 (Act No. 1 of 1999); or
- (iii) any other public entity designated by the Minister for the purposes of this Act to be a public authority.

Transfer payment

Definition deleted.

Other definitions

The definition of the term "services" remained unchanged, as did "local authority", until it was deleted and replaced with the term "municipality" on 1 July 2006. A textual amendment in the definition of the term "consideration" replaced the term "unconditional gift" with the term "donation".

Section 8 – Certain supplies of goods or services deemed to be made or not made

- **Section 8(2) proviso (iv)**

Proviso (iv) was inserted to provide relief in respect of the VAT that would arise upon deregistration of entities which fall within the definition of a “public authority” on or after 1 April 2005.

- (iv) this subsection shall not apply to a vendor that is a constitutional institution listed in Schedule 1 to the Public Finance Management Act, 1999 (Act No. 1 of 1999) or a public authority, respectively, where that vendor (other than a vendor who applied and was registered as a vendor during the period 22 December 2003 to 31 March 2005) ceases to be a vendor as a result of—
- (aa) the substitution of the definition of ‘public authority’ in the Revenue Laws Amendment Act, 2004 or the insertion of paragraph (viii) to the proviso to the definition of ‘enterprise’ in the Revenue Laws Amendment Act, (Act No. 45 of 2003); or
 - (bb) the re-classification of that vendor or part of that vendor’s activities within the Schedules to the Public Finance Management Act, 1999 (Act No. 1 of 1999) subsequent to the introduction of the Revenue Laws Amendment Act, 2004.

- **Section 8(5)**

Section 8(5) was amended so that it only applies to a “designated entity” on or after 1 April 2005. Note that the wording below is the current wording as subsequently amended in terms of Revenue Laws Amendment Act No. 20 of 2006.

(5) For the purposes of this Act a designated entity shall be deemed to supply services to any public authority or municipality to the extent of any payment made by the public authority or municipality concerned to or on behalf of that designated entity in the course or furtherance of an enterprise carried on by that designated entity.’

- **Section 8(5A)**

Section 8(5A) was inserted with effect from 1 April 2005 as a result of the amendment to section 8(5) to deal with grants paid to vendors who are not designated entities. Note that the wording below is the current wording as subsequently amended in terms of the Revenue Laws Amendment Act No. 20 of 2006.

(5A) For the purposes of section 11(2)(t), a vendor (excluding a designated entity) shall be deemed to supply services to any public authority, municipality or constitutional institution listed in Schedule 1 to the Public Finance Management Act, 1999 (Act No. 1 of 1999) to the extent of any grant paid to or on behalf of that vendor in the course or furtherance of an enterprise carried on by that vendor.’

- **Section 8(23)**

This provision was inserted with effect from 1 April 2005 to deal with low cost housing subsidies as a result of the deletion of the definition of a “transfer payment” and section 11(2)(p). Note that the wording below is the current wording as subsequently amended in terms of the Taxation Laws Amendment Act (No.7 of 2010).

(23) For the purposes of this Act a vendor shall be deemed to supply services to any public authority or municipality to the extent of any payment made to or on behalf of that vendor in terms of a national housing programme contemplated in the Housing Act, 1997 (Act No. 107 of 1997), which is approved by the Minister by regulation after consultation with the Minister responsible for Human Settlements..’

Section 11(2) – Zero-rating of services

- **Section 11(2)(p)**

The provision relating to transfer payments was deleted.

- **Section 11(2)(t)**

This provision was inserted with effect from 1 April 2005 to provide a zero-rating of the deemed supply which arises in respect of the receipt of a “grant”.

(t) the services are deemed to be supplied in terms of section 8(5A).

- **Section 11(2)(s)**

This provision was inserted with effect from 1 April 2005 to provide a zero-rating of the deemed supply which arises in respect of the receipt of a low cost housing subsidy payment.

(s) the services are deemed to be supplied to a public authority or municipality in terms of section 8(23).’

- **Section 11(2)(n)**

A textual amendment was made to this provision as a result of a “welfare organisation” being included in the definition of a “designated entity” with effect from 1 April 2005.

(n) the services comprise the carrying on by a welfare organization of the activities referred to in the definition of ‘welfare organization’ in section 1 and to the extent that any payment in respect of those services is made in terms of section 8(5) those services shall be deemed to be supplied by that organisation to a public authority or municipality.

- **Section 11(2)(u)**

This provision was inserted to provide a zero-rating in respect of the receipt of training grant by a designated entity in terms of the Skills Development Act, 1998.

(u) the services are deemed to be supplied in terms of section 8(5) by a designated entity in respect of any payment made in terms of section 10(1)(f) of the Skills Development Act, 1998 (Act No. 97 of 1998), to that designated entity.

Section 18(4) – Change in use adjustments

- **Proviso (iv) to section 18(4)**

Proviso (iv) was inserted to deny an input tax adjustment relating to assets acquired by non-taxable public authorities and certain public entities before 1 April 2005 which were applied for enterprise purposes after that date if that entity is re-classified in terms of the PFMA as a taxable entity.

- (iv) this subsection shall not apply where a constitutional institution listed in Schedule 1 or a public entity listed in Part A or C of Schedule 3 to the Public Finance Management Act, 1999 (Act No. 1 of 1999), is re-classified within the Schedules to the Public Finance Management Act, 1999 (Act No. 1 of 1999) and applies those goods or services for the purposes of consumption, use or supply in the course of making taxable supplies.

Section 23(4) – Registration of persons making supplies in the course of enterprises

- **Proviso to section 23(4)**

A proviso was inserted to provide that certain public entities would not be liable for VAT on transactions before 1 April 2005 if they were liable to register before that, but did not do so.

- (4) Where any person has—
- (a) applied for registration ... subsection (2) or (3) ..., that person shall be a vendor ...with effect from such date as the Commissioner may determine;
 - (b) not applied for registration in terms of subsection (2) and the Commissioner is satisfied that that person is liable to be registered ..., that person shall be a vendor ... with effect from the date on which that person first became liable to be registered in terms of this Act: Provided that the Commissioner may, having regard to the circumstances of the case, determine that person to be a vendor from such later date as the Commissioner may consider equitable.

Provided that where that person is a public entity listed in Schedule 1 or Part A or C of Schedule 3 to the Public Finance Management Act, 1999 (Act No. 1 of 1999), which was liable to be registered as a vendor for any supplies made on or before 31 March 2005, but did not register before 1 April 2005, the Commissioner must not register that person in respect of those supplies.

Section 40A – Liability of public authorities and certain public entities for tax and limitation of refunds

This provision was inserted to provide relief in regard to the incorrect treatment of transfer payments before 1 April 2005.

(1) This section applies in respect of the supply of goods or services on or before 31 March 2005 by any public authority or public entity listed in Schedule 1 or Part A or C of Schedule 3 to the Public Finance Management Act, 1999 (Act No. 1 of 1999).

(2) Where the Commissioner on or before 31 March 2005 issued an assessment for an amount of tax or additional tax in respect of any supply of goods or services contemplated in subsection (1), to correct a prior incorrect application of the zero per cent rate of tax in terms of section 11(2)(p) in respect of that supply, the Commissioner must, on written application, reduce that assessment to the extent that the amount of tax, additional tax penalty or interest arose as a result of that correction and was not yet paid on that date: Provided that the reduced assessment will not result in a refund to that public authority or public entity.

(3) The Commissioner may not after 31 March 2005 make any assessment to correct a prior incorrect application of the zero per cent rate of tax in terms of section 11(2)(p) in respect of any supply of goods or services contemplated in subsection (1).

(4) If a public authority or public entity incorrectly charged tax at the rate referred to in section 7(1) instead of the zero per cent rate of tax in terms of section 11(2)(p) in respect of any supply contemplated in subsection (1), the Commissioner may not refund any such tax or any penalty or interest that arose as a result of the late payment of such tax, paid by that public authority or public entity to the Commissioner.”.

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Annexure B – Public Service Act, 1994 (PSA) – National and provincial departments and their components

SCHEDULE 1

NATIONAL DEPARTMENTS AND OFFICES OF PREMIER AND HEADS THEREOF

<i>Column 1</i>	<i>Column 2</i>
NATIONAL DEPARTMENTS	HEADS OF NATIONAL DEPARTMENTS
Department of Agriculture	Director-General: Agriculture
Department of Agriculture, Forestry and Fisheries	Director-General: Agriculture, Forestry and Fisheries
Department of Arts and Culture	Director-General: Arts and Culture
Department of Basic Education	Director-General: Basic Education
Department of Communications	Director-General: Communications
Department of Cooperative Governance	Director-General: Cooperative Governance
Department of Correctional Services	Commissioner: Correctional Services
Department of Defence	Secretary for Defence
Department of Education	Director-General: Education
Department of Energy	Director-General: Energy
Department of Environmental Affairs	Director-General: Environmental Affairs
Department of Environmental Affairs and Tourism	Director-General: Environmental Affairs and Tourism
Department of Health	Director-General: Health
Department of Higher Education and Training	Director-General: Higher Education and Training
Department of Home Affairs	Director-General: Home Affairs
Department of Human Settlements	Director-General: Human Settlements
Department of International Relations and Cooperation	Director-General: International Relations and Cooperation
Department of Justice and Constitutional Development	Director-General: Justice and Constitutional Development
Department of Labour	Director-General: Labour
Department of Military Veterans	Director-General: Military Veterans
Department of Mineral Resources	Director-General: Mineral Resources
Department of Minerals and Energy	Director-General: Minerals and Energy
Department of Performance Monitoring and Evaluation	Director-General: Performance Monitoring and Evaluation
Department of Police	National Commissioner: South African Police Service
Department of Public Enterprises	Director-General: Public Enterprises
Department of Public Service and Administration	Director-General: Public Service and Administration
Department of Public Works	Director-General: Public Works
Department of Rural Development and Land Reform	Director-General: Rural Development and Land Reform
Department of Science and Technology	Director-General: Science and Technology
Department of Social Development	Director-General: Social Development
Department of Tourism	Director-General: Tourism
Department of Trade and Industry	Director-General: Trade and Industry

Column 1	Column 2
NATIONAL DEPARTMENTS	HEADS OF NATIONAL DEPARTMENTS
Department of Traditional Affairs	Director-General: Traditional Affairs
Department of Transport	Director-General: Transport
Department of Water Affairs	Director-General: Water Affairs
Department of Water Affairs and Forestry	Director-General: Water Affairs and Forestry
Department of Women, Children and People with Disabilities	Director-General: Women, Children and People with Disabilities
Economic Development Department	Director-General: Economic Development
Government Communication and Information System	Director-General: Government Communication and Information System
Independent Police Investigative Directorate	Executive Director: Independent Police Investigative Directorate
National Treasury	Director-General: National Treasury
Office of the Chief Justice	Secretary-General: Office of the Chief Justice
Office of the Public Service Commission	Director-General: Office of the Public Service Commission
Public Administration Leadership and Management Academy	Director-General: Public Administration Leadership and Management Academy
South African National Academy of Intelligence	Chief Executive Officer: South African National Academy of Intelligence
Sport and Recreation	Director-General: Sport and Recreation
State Security Agency	Director-General: State Security Agency
Statistics South Africa	Statistician-General: Statistics South Africa
The Presidency	Director-General: The Presidency
OFFICES OF PREMIER	HEADS OF OFFICES OF PREMIER
Office of the Premier: Eastern Cape	Director-General: Office of the Premier of Eastern Cape
Office of the Premier: Free State	Director-General: Office of the Premier of Free State
Office of the Premier: Gauteng	Director-General: Office of the Premier of Gauteng
Office of the Premier: KwaZulu-Natal	Director-General: Office of the Premier of KwaZulu-Natal
Office of the Premier: Limpopo	Director-General: Office of the Premier of Limpopo
Office of the Premier: Mpumalanga	Director-General: Office of the Premier of Mpumalanga
Office of the Premier: Northern Cape	Director-General: Office of the Premier of Northern Cape
Office of the Premier: North West	Director-General: Office of the Premier of North West
Office of the Premier: Western Cape	Director-General: Office of the Premier of Western Cape

SCHEDULE 2
PROVINCIAL DEPARTMENTS AND HEADS THEREOF

Column 1	Column 2
Eastern Cape	
Department of Economic Development, Environmental Affairs and Tourism	Head: Economic Development, Environmental Affairs and Tourism
Department of Education	Head: Education
Department of Health	Head: Health
Department of Human Settlements	Head: Human Settlements
Department of Local Government and Traditional Affairs	Head: Local Government and Traditional Affairs
Department of Roads and Public Works	Head: Roads and Public Works
Department of Rural Development and Agrarian Reform	Head: Rural Development and Agrarian Reform
Department of Safety and Liaison	Head: Safety and Liaison
Department of Social Development and Special Programmes	Head: Social Development and Special Programmes
Department of Sport, Recreation, Arts and Culture	Head: Sport, Recreation, Arts and Culture
Department of Transport	Head: Transport
Provincial Planning and Treasury	Head: Provincial Planning and Treasury
Free State	
Department of Agriculture	Head: Agriculture
Department of Co-operative Governance and Traditional Affairs	Head: Co-operative Governance and Traditional Affairs
Department of Economic Development, Tourism and Environmental Affairs	Head: Economic Development, Tourism and Environmental Affairs
Department of Education	Head: Education
Department of Health	Head: Health
Department of Human Settlements	Head: Human Settlements
Department of Police, Roads and Transport	Head: Police, Roads and Transport
Department of Public Works	Head: Public Works
Department of Rural Development	Head: Rural Development
Department of Social Development	Head: Social Development
Department of Sport, Arts, Culture and Recreation	Head: Sport, Arts, Culture and Recreation
Provincial Treasury	Head: Provincial Treasury
Free State Provincial Treasury	Head: Free State Provincial Treasury

Column 1	Column 2
Gauteng	
Department of Agriculture and Rural Development	Head: Agriculture and Rural Development
Department of Community Safety	Head: Community Safety
Department of Economic Development	Head: Economic Development
Department of Education	Head: Education
Department of Finance	Head: Finance
Department of Health	Head: Health
Department of Housing	Head: Housing
Department of Infrastructure Development	Head: Infrastructure Development
Department of Local Government and Traditional Affairs	Head: Local Government and Traditional Affairs
Department of Roads and Transport	Head: Roads and Transport
Department of Social Development	Head: Social Development
Department of Sport, Arts, Culture and Recreation	Head: Sport, Arts, Culture and Recreation
Provincial Treasury	Head: Provincial Treasury
KwaZulu-Natal	
Department of Agriculture, Environmental Affairs and Rural Development	Head: Agriculture, Environmental Affairs and Rural Development
Department of Arts and Culture	Head: Arts and Culture
Department of Community Safety and Liaison	Head: Community Safety and Liaison
Department of Co-operative Governance and Traditional Affairs	Head: Co-operative Governance and Traditional Affairs
Department of Economic Development and Tourism	Head: Economic Development and Tourism
Department of Education	Head: Education
Department of Finance	Head: Finance
Department of Health	Head: Health
Department of Human Settlements	Head: Human Settlements
Department of Public Works	Head: Public Works
Department of the Royal Household	Head: Royal Household
Department of Social Development	Head: Social Development
Department of Sport and Recreation	Head: Sport and Recreation
Department of Transport	Head: Transport
Limpopo	
Department of Agriculture	Head: Agriculture
Department of Co-operative Governance, Human Settlements and Traditional Affairs	Head: Co-operative Governance, Human Settlements and Traditional Affairs
Department of Economic Development, Environment and Tourism	Head: Economic Development, Environment and Tourism
Department of Education	Head: Education
Department of Health	Head: Health

Column 1	Column 2
Limpopo (continued)	
Department of Public Works	Head: Public Works
Department of Roads and Transport	Head: Roads and Transport
Department of Safety, Security and Liaison	Head: Safety, Security and Liaison
Department of Social Development	Head: Social Development
Department of Sport, Arts and Culture	Head: Sport, Arts and Culture
Provincial Treasury	Head: Provincial Treasury
Mpumalanga	
Department of Agriculture, Rural Development and Land Administration	Head: Agriculture, Rural Development and Land Administration
Department of Community Safety, Security and Liaison	Head: Community Safety, Security and Liaison
Department of Co-operative Governance and Traditional Affairs	Head: Co-operative Governance and Traditional Affairs
Department of Culture, Sport and Recreation	Head: Culture, Sport and Recreation
Department of Economic Development, Environment and Tourism	Head: Economic Development, Environment and Tourism
Department of Education	Head: Education
Department of Finance	Head: Finance
Department of Health	Head: Health
Department of Human Settlements	Head: Human Settlements
Department of Public Works, Roads and Transport	Head: Public Works, Roads and Transport
Department of Social Development	Head: Social Development
Northern Cape	
Department of Agriculture, Land Reform and Rural Development	Head: Agriculture, Land Reform and Rural Development
Department of Co-operative Governance, Human Settlements and Traditional Affairs	Head: Co-operative Governance, Human Settlements and Traditional Affairs
Department of Economic Development and Tourism	Head: Economic Development and Tourism
Department of Education	Head: Education
Department of Environment and Nature Conservation	Head: Environment and Nature Conservation
Department of Health	Head: Health
Department Roads and Public Works	Head: Roads and Public Works
Department of Social Development	Head: Social Development
Department of Sport, Arts and Culture	Head: Sport, Arts and Culture
Department of Transport, Safety and Liaison	Head: Transport, Safety and Liaison
Provincial Treasury	Head: Provincial Treasury

Column 1	Column 2
North West	
Department of Agriculture, Conservation, Environment and Rural Development	Head: Agriculture, Conservation, Environment and Rural Development
Department of Economic Development and Tourism	Head: Economic Development and Tourism
Department of Education	Head: Education
Department of Health	Head: Health
Department of Human Settlements	Head: Human Settlements
Department of Local Government and Traditional Affairs	Head: Local Government and Traditional Affairs
Department of Public Safety	Head: Public Safety
Department of Public Works, Roads and Transport	Head: Public Works, Roads and Transport
Department of Social Development	Head: Social Development
Department of Sport, Arts and Culture	Head: Sport, Arts and Culture
Provincial Treasury	Head: Provincial Treasury
Western Cape	
Department of Agriculture	Head: Agriculture
Department of Community Safety	Head: Community Safety
Department of Cultural Affairs and Sport	Head: Cultural Affairs and Sport
Department of Economic Development and Tourism	Head: Economic Development and Tourism
Department of Education	Head: Education
Department of Environmental Affairs and Development Planning	Head: Environmental Affairs and Development Planning
Department of Health	Head: Health
Department of Human Settlements	Head: Human Settlements
Department of Local Government	Head: Local Government
Department of Social Development	Head: Social Development
Department of Transport and Public Works	Head: Transport and Public Works
Provincial Treasury	Head Official: Provincial Treasury

SCHEDULE 3**PART A****NATIONAL GOVERNMENT COMPONENTS AND HEADS THEREOF**

<i>Column 1 Name of national government component</i>	<i>Column 2 Designation of head of national government component</i>	<i>Column 3 Principal national department</i>
Centre of Public Service Innovation	Executive Director: Centre of Public Service Innovation	Department of Public Service and Administration
COMSEC	Head: COMSEC	State Security Agency
Government Printing Works	Chief Executive Officer: Government Printing Works	Department of Home Affairs
Government Technical Advisory Centre	Head: Government Technical Advisory Centre	National Treasury
Intelligence Academy	Head: Intelligence Academy	State Security Agency
Municipal Infrastructure Support Agent	Head: Municipal Infrastructure Support Agent	Department of Cooperative Governance
National Intelligence Agency	Head: National Intelligence Agency	State Security Agency
South African Secret Service	Head: South African Secret Service	State Security Agency

PART B**PROVINCIAL GOVERNMENT COMPONENTS AND HEADS THEREOF**

<i>Column 1 Name of provincial government component</i>	<i>Column 2 Designation of head of provincial government component</i>	<i>Column 3 Principal Office of the Premier or provincial department</i>
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Annexure C – Public Finance Management Act, 1999 (PFMA) – Listed public entities

PUBLIC ENTITIES LISTED IN SCHEDULES 1, 2 & 3 OF THE PFMA

NOTE:

Below are the schedules to the PFMA effective from 12 October 2012. The schedules change from time to time as new public entities are listed, classified, re-classified, amalgamated or delisted. For the latest schedules, refer to the PFMA homepage on National Treasury's website www.treasury.gov.za.

Schedule 1 Constitutional Institutions	Schedule 2 Major Public Entities
<ol style="list-style-type: none"> 1) The Commission on Gender Equality 2) The Commission for the Promotion and Protection of the Rights of Cultural, Religious and Linguistic Communities 3) The Financial and Fiscal Commission 4) The Human Rights Commission 5) The Independent Communications Authority of South Africa 6) The Independent Electoral Commission 7) The Municipal Demarcation Board 8) The Pan South African Language Board 9) The Public Protector of South Africa 	<ol style="list-style-type: none"> 1) Air Traffic and Navigation Services Company 2) Airports Company (ACSA) 3) Alexkor Limited 4) Armaments Corporation of South Africa (ARMSCOR) 5) Broadband Infrastructure Company (Pty) Ltd 6) CEF (Pty) Ltd (formerly Central Energy Fund) 7) DENEL (Pty) Ltd 8) Development Bank of Southern Africa 9) ESKOM 10) Independent Development Trust (IDT) 11) Industrial Development Corporation of South Africa Limited (IDC) 12) Land and Agricultural Development Bank of South Africa 13) SA Broadcasting Corporation Limited 14) South African Express (Proprietary) Limited 15) SA Forestry Company Limited 16) SA Nuclear Energy Corporation Limited 17) SA Post Office Limited 18) South African Airways Limited 19) Telkom SA Limited 20) Trans-Caledon Tunnel Authority 21) Transnet Limited <p>All subsidiaries of the above major public entities</p>

Schedule 3	
Other Public Entities	
Part A: National Public Entities	
1) Accounting Standards Board	38) Financial Services Board
2) Africa Institute of South Africa, Pretoria	39) Food and Beverages Manufacturing Industry Sector Education and Training Authority
3) African Renaissance and International Cooperation Fund	40) Freedom Park Trust
4) Agricultural Research Council	41) Health and Welfare Sector Education and Training Authority
5) Agricultural Sector Education and Training Authority (AGRISETA)	42) Housing Development Agency (HDA)
6) Artscape	43) Human Sciences Research Council (HSRC)
7) Banking Sector Education and Training Authority	44) Independent Regulatory Board for Auditors
8) Boxing South Africa	45) Ingonyama Trust Board
9) Breede River Catchment Management Agency	46) Inkomati Catchment Management Agency
10) Castle Control Board	47) Insurance Sector Education and Training Authority
11) Chemical Industries Education and Training Authority	48) International Marketing Council (IMC)
12) Commission for Conciliation, Mediation & Arbitration	49) International Trade Administration Commission
13) Community Schemes Ombud Service	50) iSimangaliso Wetland Park
14) Companies and Intellectual Property Commission	51) Iziko Museums of Cape Town
15) Companies Tribunal	52) Legal Aid Board
16) Compensation Fund, including Reserve Fund	53) Local Government, Water and Related Services Sector Education and Training Authority
17) Competition Commission	54) Luthuli Museum
18) Competition Tribunal	55) Manufacturing, Engineering and Related Services Education and Training Authority
19) Construction Education and Training Authority	56) Marine Living Resources Fund
20) Construction Industry Development Board	57) Market Theatre Foundation
21) Council for Geoscience	58) Media Development and Diversity Agency
22) Council for Medical Schemes	59) Media, Information and Communication Technologies Sector Education Training Authority
23) Council for the Built Environment (CBE)	60) Medical Research Council of South Africa (MRC)
24) Council on Higher Education	61) Mine Health and Safety Council
25) Cross-Border Road Transport Agency	62) Mining Qualifications Authority
26) Culture, Arts, Tourism Hospitality and Sports Education and Training Authority	63) Municipal Infrastructure Investment Unit
27) Die Afrikaanse Tall Museum	64) National Agricultural Marketing Council
28) Ditsong: Museums of South Africa	65) National Arts Council of South Africa
29) EDI Holdings (Pty) Ltd	66) National Consumer Commission
30) Education and Labour Relations Council	67) National Consumer Tribunal
31) Education, Training and Development Practices Sector Education and Training Authority	68) National Credit Regulator
32) Energy and Water Sector Education and Training Authority	69) National Development Agency
33) Estate Agency Affairs Board	70) National Economic, Development and Labour Council
34) Fibre Processing Manufacturing Sector Education and Training Authority	71) National Electronic Media Institute of SA
35) Film and Publication Board	72) National Empowerment Fund
36) Financial and Accounting Services Training Authority	73) National Energy Regulator of South Africa
37) Financial Intelligence Centre	74) National Film and Video Foundation
	75) National Gambling Board of South Africa
	76) National Health Laboratory Service (NHLS)

Schedule 3	
Other Public Entities	
<i>Part A: National Public Entities (continued)</i>	
77) National Heritage Council of South Africa	116) South African Library for the Blind
78) National Home Builders Registration Council (NHBRC)	117) South African Local Government Association (SALGA)
79) National Housing Finance Corporation	118) South African Maritime Safety Authority
80) National Library of South Africa	119) South African National Accreditation System
81) National Lotteries Board	120) South African National Biodiversity Institute (SANBI)
82) National Metrology Institute of South Africa	121) South African National Energy Development Institute
83) National Museum, Bloemfontein	122) South African National Parks (SANPARKS)
84) National Nuclear Regulator	123) South African National Space Agency
85) National Regulator for Compulsory Specifications	124) South African Qualifications Authority (SAQA)
86) National Research Foundation (NRF)	125) South African Revenue Service (SARS)
87) National Student Financial Aid Scheme	126) South African Social Security Agency
88) National Urban Reconstruction and Housing Agency (NURCHA)	127) South African Tourism
89) National Youth Development Agency (NYDA)	128) South African Weather Service
90) Nelson Mandela Museum, Umtata	129) Special Investigation Unit
91) Office of the Ombudsman for Financial Services Providers	130) State Information Technology Agency (SITA)
92) Office of the Pension Funds Adjudicator	131) Technology Innovation Agency (TIA)
93) Performing Arts Council of the Free State	132) The Co-Operative Banks Development Agency
94) Perishable Products Export Control Board	133) The National English Literary Museum
95) Ports Regulator of South Africa	134) The National Radioactive Waste Disposal Institute
96) Private Security Industry Regulatory Authority	135) The National Skills Fund
97) Productivity SA	136) The Playhouse Company
98) Public Sector Education and Training Authority	137) The Social Housing Regulatory Authority (SHRA)
99) Quality Council for Trades and Occupations - QCTO	138) The South African Institute for Drug-free Sport
100) Railway Safety Regulator	139) The South African National Roads Agency (SANRAL)
101) Road Accident Fund	140) The South African State Theatre
102) Road Traffic Infringement Agency - RTIA	141) Thubelisha Homes
103) Road Traffic Management Corporation	142) Transport Education and Training Authority
104) Robben Island Museum, Cape Town	143) uMalusi Council for Quality Assurance in General and Further Education and Training
105) Rural Housing Loan Fund	144) Unemployment Insurance Fund (UIF)
106) Safety and Security Sector Education and Training Authority	145) Universal Service and Access Agency of South Africa
107) Servcon Housing Solutions (Pty) Ltd	146) Universal Service and Access Fund
108) Services Sector Education and Training Authority	147) Urban Transport Fund
109) Small Enterprise Development Agency	148) Voortrekker Museum
110) Social Housing Foundation	149) War Museum of the Boer Republics
111) South African Civil Aviation Authority (CAA)	150) Water Research Commission
112) South African Council for Educators	151) Wholesale and Retail Sector Education and Training Authority
113) South African Diamond and Precious Metals Regulator	152) William Humphreys Art Gallery
114) South African Heritage Resources Agency	153) Windybrow Centre
115) South African International Marketing Council / Brand South Africa	
	All subsidiaries of the above national public entities

**Schedule 3
Other Public Entities**

Part B: National Government Business Enterprises

<ol style="list-style-type: none"> 1) Amatola Water Board 2) Bloem Water 3) Botshelo Water 4) Bushbuckridge Water Board 5) Council for Mineral Technology (Mintek) 6) Council for Scientific and Industrial Research (CSIR) 7) Export Credit Insurance Corporation of South Africa Limited 8) Inala Farms (Pty) Ltd 9) Khula Enterprises 10) Lepelle Northern Water 11) Magalies Water 12) Mhlathuze Water 13) Namakwa Water Board 	<ol style="list-style-type: none"> 14) Ncera Farms (Pty) Ltd 15) Onderstepoort Biological Products Limited 16) Overberg Water 17) Passenger Rail Agency of South Africa (PRASA) 18) Pelladrift Water Board 19) Public Investment Corporation Limited (PIC) 20) Rand Water 21) SA Bureau of Standards (SABS) 22) Sasria Limited 23) Sedibeng Water 24) Sentech 25) State Diamond Trader 26) Umgeni Water <p>All subsidiaries of the above government business entities</p>
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Part C: Provincial Public Entities

<p><i>Eastern Cape:</i></p> <ol style="list-style-type: none"> 1) Eastern Cape Appropriate Technology Unit 2) Eastern Cape Arts Council 3) Eastern Cape Gambling and Betting Board 4) Eastern Cape Liquor Board 5) Eastern Cape Parks and Tourism Agency (ECPTA) 6) Eastern Cape Rural Finance Corporation Limited 7) Eastern Cape Socio-Economic Consultative Council 8) Eastern Cape Youth Commission <p><i>Limpopo (Northern Province):</i></p> <ol style="list-style-type: none"> 1) Limpopo Agribusiness Development Corporation 2) Limpopo Appeal Tribunals 3) Limpopo Development Enterprise 4) Limpopo Development Tribunals 5) Limpopo Gambling Board 6) Limpopo Housing Board 7) Limpopo Liquor Board 8) Limpopo Local Business Centres 9) Limpopo Panel of Mediators 10) Limpopo Planning Commission 11) Limpopo Roads Agency 12) Limpopo Tourism and Parks Board 13) Trade and Investment Limpopo 	<p><i>KwaZulu-Natal:</i></p> <ol style="list-style-type: none"> 1) Agri-Business Development Agency 2) Amafa AkwaZulu Natali 3) Dube Tradeport Corporation 4) Ezemvelo KwaZulu-Natal Wildlife 5) KwaZulu-Natal Gambling Board 6) KwaZulu-Natal Gaming and Betting Board 7) KwaZulu-Natal House of Traditional Leaders 8) KwaZulu-Natal Provincial Planning and Development Commission 9) KwaZulu-Natal Tourism Authority 10) Natal Sharks Board 11) Royal Household Trust 12) Trade and Investment KwaZulu-Natal 13) uMsekeli Municipal Support Services <p><i>Gauteng:</i></p> <ol style="list-style-type: none"> 1) Blue IQ Investment Holdings (Pty) Ltd 2) Gauteng Economic Development Agency 3) Gauteng Enterprise Propeller 4) Gauteng Gambling Board 5) Gauteng Partnership Fund (GPF) 6) Gauteng Tourism Authority (GTA) 7) Gautrain Management Agency 8) XHASA ATC Agency
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**Schedule 3
Other Public Entities**

Part C: Provincial Public Entities (continued)

<p>Western Cape:</p> <ol style="list-style-type: none"> 1) Destination Marketing Organisation 2) WC Commission for the Environment 3) WC Cultural Commission 4) WC Gambling and Racing Board 5) WC Investment and Trade Promotion Agency 6) WC Language Committee 7) WC Liquor Board 8) WC Nature Conservation Board 9) WC Provincial Development Council <p>Mpumalanga:</p> <ol style="list-style-type: none"> 1) Mpumalanga Gambling Board 2) Mpumalanga Regional Training Trust 3) Mpumalanga Tourism and Parks Board <p>Free State:</p> <ol style="list-style-type: none"> 1) Free State Gambling and Liquor Authority (FSGLA) 2) Free State Investment Promotion Agency 3) Free State Tourism Authority 4) Phakisa Major Sport and Development Corporation 	<p>North West:</p> <ol style="list-style-type: none"> 1) Invest North West 2) Mmabana Arts, Culture and Sport Foundation 3) NW Eastern Region Entrepreneurial Support Centre 4) NW Gambling Board 5) NW Housing Corporation 6) NW Parks and Tourism Board 7) NW Provincial Aids Council 8) North West Provincial Heritage Resourced Authority 9) Provincial Arts and Culture Council 10) NW Youth Development Trust <p>Northern Cape:</p> <ol style="list-style-type: none"> 1) Kalahari Kid Corporation (KKC) 2) Northern Cape Economic Development, Trade and Investment Promotion Agency 3) Northern Cape Gambling Board 4) Northern Cape Liquor Board 5) Northern Cape Tourism Authority <p>All subsidiaries of any of the above provincial public entities</p>
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Part D: Provincial Government Business Enterprises

<p>Eastern Cape:</p> <ol style="list-style-type: none"> 1) East London Industrial Development Zone Corporation 2) Eastern Cape Development Corporation 3) Mayibuye Transport Corporation <p>KwaZulu-Natal:</p> <ol style="list-style-type: none"> 1) Cowslip Investments (Pty) Ltd 2) Ithala Development Finance Corporation 3) Mjindi Farming (Pty) Ltd 4) Mpendle-Ntambanana Agricultural Company (Pty) Ltd 5) Richards Bay Industrial Development Zone <p>North West:</p> <ol style="list-style-type: none"> 1) Mafikeng Industrial Development Zone (Proprietary Limited) 2) NW Development Corporation 3) NW Transport Investments (Pty) Ltd 	<p>Western Cape:</p> <ol style="list-style-type: none"> 1) Casidra (Pty) Ltd <p>Free State:</p> <ol style="list-style-type: none"> 1) Free State Development Corporation <p>Limpopo (Northern Province):</p> <ol style="list-style-type: none"> 1) Gateway Airport Authority Limited 2) Limpopo Development Corporation <p>Mpumalanga:</p> <ol style="list-style-type: none"> 1) Mpumalanga Agricultural Development Corporation 2) Mpumalanga Economic Empowerment Corporation 3) Mpumalanga Housing Finance Company <p>All subsidiaries of any of the above provincial government enterprises</p>
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Annexure D – Examples

Example 1 – Low cost housing payment made to a developer with contribution by the beneficiary

The provincial Department of Human Settlement (DHS) (previously known as the Department of Housing) pays a low cost housing developer for developing houses for the poor. The recipients also agree to pay an additional R5 000 each for extra work performed on the houses which is not covered by the housing subsidy.

Before 1 April 2005

DHS enters into a contract with and pays a property developer R5 000 000 to develop 100 low cost housing units (R50 000 per beneficiary). When the developer received the R5 000 000 subsidy amount from DHS, that payment would have been treated as a “transfer payment” which was zero-rated in terms of sections 8(5) and 11(2)(p). The balance of the consideration being R500 000 (R5 000 x 100) received for the houses supplied to the beneficiaries would have been subject to VAT at the standard rate.

The output tax to be declared by the developer in this example would therefore be calculated as follows:

		R
Transfer payment	R5 000 000 at 0%	nil
Payment by recipients	R500 000 x 14/114	<u>61 403,51</u>
Total output tax		<u>61 403,51</u>

On or after 1 April 2005

There is essentially no difference in the VAT treatment of the supplies concerned, except that the payments will now be zero-rated in terms of sections 8(23) and 11(2)(s) which cater specifically for housing subsidy payments.

Example 2 – Payment to a municipality for an actual supply of land used for non-taxable purposes

Department of Rural Development and Reform (DRDLR) (previously known as Department of Land Affairs (DLA)) pays a municipality an amount of money to transfer a piece of vacant land (commonage) belonging to the municipality to a tribe in the area. DRDLR also makes funds available to the tribe to build a community hall on the land.

Before 1 April 2005

Since the supply of the vacant land would not have constituted an actual taxable supply by the municipality there would have been no deemed supply by the municipality to the DLA. The supply would, however, have been non-taxable as the land was not used for “enterprise” purposes at that time. The payment for the land would have been reflected as an out-of-scope receipt which would be reflected in Block 3 of the municipality’s VAT 201 return and not in Block 2 (zero-rated supplies). Since the tribe is not a vendor and is not making any taxable supplies, there is also no deemed supply to the DRDLR on receipt of the funds to build the community hall.

On or after 1 April 2005

The supply by the municipality to a third person (the tribe) would be taxable at the standard rate as it is not a “grant”. No deemed supply arises as there is an actual supply in terms of section 7(1)(a).

Example 3 – Low cost housing subsidy paid to a municipality

The Department of Human Settlement (DHS) (previously known as the Department of Housing) pays a municipality an amount as a subsidy to develop land for a township development project in the municipality's jurisdiction as part of an urban planning initiative. It is projected that the houses will be sold for a small profit.

Before 1 April 2005

Since township development was one of the taxable categories of businesses listed in Government Notice No. 2570 (21 October 1991), the acquisition and supply of the land and the houses would have been in the course or furtherance of the municipality's "enterprise". This is provided that the income (including the transfer payment or grant and a reasonable provision for depreciation) would be sufficient to cover the costs of the development. Therefore, in terms of section 8(5), the municipality is deemed to have supplied a taxable service to DHS (public authority). The payment concerned was therefore regarded as "transfer payment" which was subject to VAT at the zero rate in the hands of the municipality. This is because DHS (public authority) does not actually receive any goods or services in return for the payment. The taxable supply of land and houses is instead made by the municipality to the purchasers of the houses. Should the municipality be required to report to DHS from time to time on the progress made in respect of the development, this will be regarded as incidental, and will not be regarded as an actual supply of services to DHS as contemplated in section 7(1)(a) in return for the payment.

If the municipality appoints a contractor to build the houses, the payment by the municipality to the contractor is subject to VAT at the standard rate since it is in respect of an actual supply of goods or services to the municipality. The municipality would deduct input tax on VAT expenses incurred in supplying the land and houses, as the township development is a taxable activity conducted by that municipality.

It should, however, be noted that if the municipality was appointed to merely receive and disburse the payments to the building contractor on behalf of the public authority (that is, as an agent of the public authority), the situation would be different. In that case the payments would be zero-rated in the hands of the building contractor and not the municipality. In such a case, the municipality will not reflect the payment at all on the VAT 201 return since it is not in respect of any supplies made by them.

On or after 1 April 2005

Same as above, except that the payment to the municipality would constitute a "grant". Since the grant is received in connection with the enterprise activities of the municipality, a deemed supply in terms of section 8(5A) arises which qualifies for the zero rate in terms of section 11(2)(t).

It is also possible that sections 8(23) and 11(2)(s) may apply, depending on whether or not the payments concerned are made in terms of an approved housing subsidy scheme contemplated in those provisions.

Example 4 – Incentive payment for exported goods

The Department of Trade and Industry (DTI) pays an amount of money in terms of a scheme to persons who export goods in excess of a certain value from South Africa.

Before 1 April 2005

Since the export of goods is a taxable supply and the goods exported are supplied to persons other than the DTI (that is, DTI does not receive any goods or services in return for the payment), the vendor receiving the payment is deemed to supply a service in terms of section 8(5) to DTI. The receipt would have been regarded as a transfer payment which was zero-rated in the hands of the recipient (vendor) in terms of section 11(2)(p). There is no VAT implication for recipients who are not vendors.

On or after 1 April 2005

The same as above would apply, except that the payment concerned would constitute a “grant”. Since it is in respect of that vendor’s taxable supplies, a deemed supply in terms of section 8(5A) arises, which qualifies for the zero rate in terms of section 11(2)(t). However, this will not be the case if the recipient is a “designated entity”, in which case it would be taxed at the standard rate in terms of section 8(5).

Example 5 – Payment to a public authority which has been notified to register

The Department of Home Affairs (DHA) pays an amount to the Government Printing Works (GPW) for the printing of I.D. books and passports.

Before 1 April 2005

GPW was notified to register for VAT with effect from the inception of VAT in South Africa. Since DHA is receiving and paying for an actual service from a registered vendor in terms of section 7(1)(a), it does not qualify as a transfer payment, nor is there any deemed supply in terms of section 8(5).

On or after 1 April 2005

Same as above. Note that the GPW is a “designated entity” on or after 1 April 2005 as it was notified to register and continues to be registered.

Example 6 – Procurement of supplies by a public authority

The Department of Public Works (DPW) pays a building contractor an amount to paint its office premises and to install an air-conditioning system.

Before 1 April 2005

Since DPW is actually receiving goods and services in return for the payment made, the payment does not qualify as a transfer payment. Section 8(5) does not apply and DPW will have to include the VAT that it will be charged in the total cost which it has budgeted to cover the project.

On or after 1 April 2005

Same as above.

Example 7 – Subsidy paid by a public authority to a municipality for taxable purposes

Department of Water Affairs (DWA) pays a subsidy to a municipality to enable that municipality to sink boreholes and provide necessities such as taps, piping and water storage facilities to enable the poor to get access to free water.

Before 1 April 2005

Since DWA is a public authority and the payment is in respect of the taxable supply of water in terms of paragraph (c)(i) and (iii) of the definition of “enterprise” (as it read at the time) by the municipality to certain members of the community, the municipality is deemed to make a supply to DWA in terms of section 8(5). The payment will be a zero-rated transfer payment if it is not appropriated in terms of the DOR Act.

The fact that this service is provided for free to a specific sector of the community does not alter the fact that the supply of water by the municipality is a taxable supply for nil consideration in terms of section 10(23). Furthermore, it does not matter that the funds are expended on capital infrastructure rather than operational costs. As long as (and to the extent that) the capital infrastructure is for taxable supplies, that receipt qualified as a zero-rated “transfer payment”.

Should the municipality commission a contractor to sink the boreholes and erect the water piping infrastructure, it will be entitled to deduct input tax in this regard. The contractor will be required to charge VAT at the standard rate (if registered as a vendor).

On or after 1 April 2005

Same as the above, except that the payment constitutes a “grant” and is zero-rated in terms of section 8(5A) read together with section 11(2)(t). If the payment was included in the municipality’s “equitable share” grant in terms of the DOR Act, it will also qualify for the zero rate in terms of these provisions.

Example 8 – Gratuitous payment by a municipality to a welfare organisation

A municipality pays an amount of money to a welfare organisation (vendor) to assist members of the local rural community to acquire land and teach them about sustainable development.

Before 1 April 2005

The welfare organisation will be making taxable supplies to persons other than the municipality, and it will be deemed to make a supply of services to that municipality in terms of section 8(5) in respect of the payment that it receives. However, as the payment is not made by a public authority, it cannot be a “transfer payment”, and hence it cannot be zero-rated in terms of section 11(2)(p). The payment does, however, qualify to be zero-rated in terms of section 11(2)(n) as the recipient is a “welfare organisation” and the payment is for the carrying on of a welfare activity.

On or after 1 April 2005

Same as the above, except that a welfare organisation is regarded as a “designated entity”. The payment also constitutes a “grant” and is zero-rated in terms of section 8(5) read together with section 11(2)(n) (as amended).

Example 9 – Disaster relief payments

National Treasury is instructed by Parliament to make available emergency funds to be paid to certain farmers in the Free State and Northern Cape regions as drought subsidies to replace damaged or lost standing crops and livestock. Payments are made available via the Department of Rural Development and Land Reform (DRDLR) (formerly known as the Department of Land Affairs) on application.

Before 1 April 2005

Any farmer (vendor) who applies for and receives the subsidy (grant-in-aid) will be deemed in terms of section 8(5) to make a supply to DRDLR since the goods lost or damaged were used for taxable supplies made by the farmers and the DRDLR does not receive any goods or services in return for the subsidy payment. As the subsidy is a “transfer payment”, it will qualify for zero-rating in the hands of the farmer (vendor). There is no VAT implication for recipients who are not vendors.

On or after 1 April 2005

Same as the above, except that the payment constitutes a “grant” and is zero-rated in terms of section 8(5A) read together with section 11(2)(t) (provided that the farming enterprise is not a “designated entity”).

On or after 7 February 2007

If the disaster relief was in the form of compensation paid by a public authority in terms of section 19 of the Animal Diseases Act No. 35 of 1984 for the supply of a “controlled animal or thing” as defined in that Act to that public authority, the supply of the affected animals is subject to VAT at the zero rate in terms of section 11(1)(r).

Example 10 – Infrastructure grant paid to a municipality for roads and street lighting

The Department of Transport (DoT) makes a payment to a municipality to provide public roads and street lighting for the general public in the municipality’s jurisdiction.

Before 1 April 2005

The supply of public roads and street lighting by a municipality is usually funded out of the municipality’s rates account. Such supplies were therefore not normally considered to be taxable as contemplated in paragraph (c)(iv) of the definition of “enterprise” (as it read at the time). No deemed supply would therefore have arisen between the municipality and DoT in terms of section 8(5) in regard to that payment and it would not have been zero-rated in terms of section 11(2)(p), even though it is a “transfer payment”.

It follows that the municipality cannot deduct any input tax on any goods or services acquired in order to provide the public roads and street lighting to the general public which are acquired with the funds made available for that purpose.

If the municipality concerned charged a flat rate for its services as contemplated in terms of section 8(6)(a), all the goods and services provided by that municipality would have been deemed to be taxable. In such a case, the deemed supply to DoT would have been zero-rated in terms of section 11(2)(p). The municipality in this instance will be allowed to deduct the input tax incurred in providing public roads and street lighting.

On or after 1 April 2005 but before 1 July 2006

Same as above, except that a municipality is not a “designated entity”. Consequently, with the amendments to section 8(5), this section no longer applies to the municipality. If the grant payment is in respect of the municipality’s taxable supplies (for example, a municipality that charges the “flat rate”), the payment will be zero-rated in terms of section 8(5A) and 11(2)(t). Alternatively, if the payment is in respect of the exempt supplies of the municipality, the payment will be out-of-scope for VAT purposes.

On or after 1 July 2006

With effect from 1 July 2006, paragraph (c) of the definition of “enterprise” and the definition of “local authority” was deleted. The effect of this is that from 1 July 2006, most of the supplies by a municipality (formerly known as a local authority) became taxable at the standard rate under paragraph (a) of the definition of “enterprise”. Therefore, the payment will be regarded as a zero-rated grant in terms of sections 8(5A) and 11(2)(t) as it is received for enterprise purposes by the municipality. It follows that the VAT incurred in providing those facilities may be deducted as input tax.

Example 11 – Transport subsidy paid partially for taxable purposes

Department of Transport (DoT), as part of its recapitalisation programme to scrap 10 000 old taxis makes a payment (scrapping allowance) of R50 000 to taxi owners for each legally-registered old minibus that was scrapped

Before 1 April 2005

No such payments were made before 1 April 2005.

On or after 1 April 2005

DoT is a public authority, but some of the recipients concerned may make both taxable supplies (zero-rated international transport) and exempt supplies (local fare-paying passenger transport) in terms of sections 11(2)(a) and 12(g) respectively. Each vendor is therefore deemed to make a supply to DoT in terms of section 8(5A) only to the extent that it is in respect of the taxable part of that vendor’s business.

For instance, assume the following facts regarding one of the recipients (vendor):

- Payment of R50 000 received to buy a new taxi.
- The new taxi costs R228 000 (including VAT).
- The vendor makes 70% taxable supplies (international bus transport) and 30% exempt supplies (local taxi transport).

In this example, the vendor will zero-rate 70% of the payment (R35 000) in terms of section 11(2)(t) as it will constitute a “grant” (declared in Block 2 on the VAT 201 return). The balance (R15 000) is declared in Block 3 of the VAT 201 return as non-taxable (out-of-scope) income. The vendor will be allowed to deduct input tax on the expense relating to the new taxi as follows:

$$R228\,000 \times 14 / 114 \times 70\% = \underline{R19\,600}.$$

However, it should be noted that the most common situation will be that there will be no deemed supply at all, as the payment will in most cases relate exclusively to exempt activities (local passenger transport by road).

The payment in most cases will therefore be out-of-scope for VAT purposes as the recipients will not be vendors.

Where the taxi owner does not make taxable supplies with the taxi, but that person is registered for VAT in respect of other taxable supplies, for example, if the taxi owner has a taxi business as well as a building supplies business, the entire receipt (R50 000) must be declared in Block 3 of the VAT 201 return as non-taxable (out-of-scope) income. The vendor will not be allowed to deduct input tax on the expenses incurred in buying the new taxi as the expense is not in the course or furtherance of the building supplies business to which the VAT registration applies.

Example 12 – Relief relating to the incorrect treatment of a “transfer payment” – section 40A

A Schedule 3C PFMA public entity supplies management services to a Schedule 3A PFMA public entity. VAT should have been charged at 14% on the services in terms of section 7(1)(a), but both parties were under the mistaken impression that the payment was a zero-rated “transfer payment.”

SARS raised an assessment against the Schedule 3C PFMA entity for an amount of R50 000 in the tax period ending March 2003. Since that date, SARS recovered R35 000 of that amount by offsetting refunds which were due to that entity. The Schedule 3C PFMA public entity was required to deregister on 1 April 2005, but it still has a VAT liability of R15 000 plus penalty and interest thereon.

If the conditions in section 40A(1) and (2) are met, the Commissioner was required to reduce the assessment for the tax period ending March 2003 by R15 000, plus the penalty and interest thereon, if written application was made by the vendor in this regard. The Commissioner could not reduce the assessment for that tax period by reversing the original assessment of R35 000, or any part of the tax, additional tax, penalty or interest which was already recovered, as this would have resulted in the vendor obtaining a refund [which would be in contravention of the proviso to section 40A(2)].

In terms section 40A(3), where an assessment had not been issued in regard to those supplies by 31 March 2005, SARS was prevented from raising an assessment to recover those amounts on or after 1 April 2005. In addition, if the vendor had incorrectly declared output tax at 14% on a “transfer payment”, the Commissioner could not refund the output tax, or any amount paid which had been applied to offset any penalty or interest in respect of that outstanding tax. (Section 40A(4).)

Example 13 – Non-liability for a failure to register before 1 April 2005 – proviso to section 23(4)

Assume that the Schedule 3C PFMA entity in **Example 12** above did not register for VAT in respect of the management services which it supplied. In such a case, with effect from 1 April 2005, the Commissioner will not be allowed to retrospectively register the that entity and make it account for the input tax and output tax for any period before 1 April 2005.

With effect from 1 April 2005, the Schedule 3C public entity is regarded as a “public authority” and will therefore not be liable (or allowed) to register for VAT in respect of those management services, unless it is notified to register in terms of paragraph (b)(i) of the definition of “enterprise”.