

BINDING GENERAL RULING (VAT) 4 (Issue 4)

DATE: 25 April 2025

ACT : VALUE-ADDED TAX ACT 89 OF 1991
SECTION : SECTION 17(1)
SUBJECT : APPORTIONMENT METHODOLOGY TO BE APPLIED BY A MUNICIPALITY

Preamble

For the purposes of this ruling –

- **“BGR”** means a binding general ruling issued under section 89 of the Tax Administration Act 28 of 2011;
- **“capital asset”** means the asset described in E3 in the Annexure;
- **“extraordinary income”** means the income defined in E4 in the Annexure;
- **“JIBAR”** means the Johannesburg Interbank Average Rate, and includes reference to ZARONIA where applicable (see N3);
- **“mixed expenses”** means goods or services acquired partly for the purpose of consumption, use or supply in the course of making taxable supplies and partly for another intended use;
- **“MFMA”** means the Municipal Finance Management Act 56 of 2003;
- **“MSA”** Municipal Systems Act 32 of 2000;
- **“municipality”** means any municipality falling within any of the categories of municipalities described in section 155 of the Constitution of the Republic of South Africa, Act 108 of 1996;
- **“section”** means a section of the VAT Act unless otherwise stated;
- **“VAT”** means value-added tax;
- **“VAT Act”** means the Value-Added Tax Act 89 of 1991; and
- any other word or expression bears the meaning ascribed to it in the VAT Act.

1. Purpose

This BGR prescribes the apportionment method that a municipality must use to determine the ratio contemplated in section 17(1) to calculate the amount of VAT that may be deducted as input tax on mixed expenses.

2. Background

Municipalities receive several different types of income to finance their operations. Some income streams result from supplies made by the municipality whilst others are received due to statutory requirements placed on, for instance, residents. The VAT treatment of each income stream must be evaluated separately, determined based on

either special rules contained in the VAT Act (such as grants) or general VAT principles.

The VAT incurred on expenses to earn the aforementioned income may only be deducted to the extent that it constitutes “input tax” as defined in section 1(1), more specifically, that the goods or services must be acquired for consumption, use, or supply in the course of making its taxable supplies. A municipality is therefore required to directly attribute the VAT on goods or services acquired to the intended purpose for which the goods or services will be consumed, used, or supplied.

The income streams, with subsequent input tax deductions based on direct attribution, can be categorised as follows for VAT purposes:¹

- Taxable supplies

Supplies subject to VAT at either the standard or zero rate and in relation to which the municipality can deduct input tax on expenses incurred. Examples include grants, municipal property rates, and the supply of water, or electricity.

- Exempt supplies

Supplies made that are not subject to VAT, and the municipality is also not entitled to deduct any VAT on expenses incurred for this purpose. Examples include the earning of interest, transportation of passengers in a bus, and rental of dwellings.

- Out-of-scope income streams

Income that does not result from any supplies made by the municipality. These income streams are not subject to VAT and no VAT may be deducted on expenses incurred to earn the income. Examples include dividends, statutory fines, and penalties.

It is accepted, however, that municipalities incur operating expenses that cannot be directly attributed to a specific purpose, also referred to as mixed expenses. In these instances, municipalities are required to apportion the VAT incurred on such expenses to determine the extent to which such VAT relate to the making of taxable supplies, and which therefore may be deducted as input tax.

3. Discussion

Section 17(1) provides that the extent to which a municipality may deduct input tax in respect of mixed expenses is determined by means of a ratio determined by the Commissioner for the South African Revenue Service (SARS) in terms of a ruling contemplated in Chapter 7 of the Tax Administration Act, 2011 (that is, a binding general ruling) or a ruling under section 41B (that is, a VAT class ruling, or a VAT ruling).

¹ See the *VAT 419 – Guide for Municipalities* for more details.

4. Ruling

The formula set out below, being the default method of apportionment to be applied by all municipalities in the absence of an alternative method approved by the Commissioner in terms of a ruling as described above, constitutes a BGR under section 89 of the Tax Administration Act 28 of 2011.

Formula:

$$y = \frac{a}{a + b + c} \times \frac{100}{1}$$

Where, having regard to the exclusions, adjustments and notes listed below –

“y” = the apportionment ratio or percentage;

“a” = the value of all taxable supplies (including deemed supplies) made during the period;

“b” = the value of all exempt supplies made during the period; and

“c” = the sum of any other amounts of income not included in “a” or “b” that was received or accrued during the period, whether in respect of a supply or not.

The following are **excluded** from the formula set out above:

E1	Foreign exchange differences that do not form part of any hedging activities
E2	Accounting entries, such as fair value adjustments, resulting in income reflected in the Annual Financial Statements ² to ensure compliance with relevant Regulatory Frameworks
E3	The supply of capital assets
E4	Extraordinary income
E5	The value of any goods or services supplied if input tax on those goods or services was specifically denied under section 17(2)
E6	Change-in-use adjustments under sections 18, 18A, 18C, and 18D
E7	Indemnity payments received as envisaged under section 8(8) to the extent that the indemnity payments relate to extraordinary income or capital assets
E8	The value of municipal bonds issued as a manner of raising funds
E9	Interest earned from – - the municipality’s current account (meaning, the account used for day-to-day business operations); and - the SARS

² Annual Financial Statements, generally compiled to comply with relevant regulatory requirements as set out in the MFMA.

Adjustments to the value of certain income streams included in the formula set out above:

A1	Interest, other than the interest excluded from the formula in E11, from any investments, including savings accounts, must be included as follows: Interest received for the year $\times$ (prime rate – JIBAR)
A2	Dividends The amount to be included in the formula on dividends received from investment activities (including investments held in municipal entities, public private partnerships and ad-hoc or minority investments) must be determined using the following formula: 3-year moving average of dividends received/accrued during the year $\times$ (prime rate – JIBAR)

General notes for using the formula set out above:

N1	The exclusions and adjustments to the formula are subject to the further explanations and discussions as set out in Annexure A.
N2	“c” in the formula will typically include, but is not limited to, items such as statutory fines, penalties, dividends etc. However, traffic fines are only included in “c” to the extent that payment has actually been received by the municipality.
N3	The prime rate to be used for all the adjustments listed above is the applicable prime rate at the end of the financial year. The JIBAR rate to be used for all adjustments listed above is the 12-month term rate quoted on the last day of the financial year. If more appropriate for the municipality, or should the JIBAR no longer be applicable, the ZARONIA may be used; the rate being the equivalent to the above stated JIBAR. For ease of reference, the reference to JIBAR in this document includes reference to the ZARONIA.
N4	The term “value” excludes the VAT component of the supply.
N5	The apportionment ratio must be rounded off to two decimal places.
N6	If the formula yields an apportionment ratio of 95% or more, the full amount of VAT incurred on mixed expenses may be deducted [referred to as the <i>de minimis</i> rule and effected under proviso (i) to section 17(1)] as input tax.
N7	Municipalities using their previous year’s turnover to determine the current year’s apportionment ratio are required to make an adjustment (that is, the difference in the ratio when applying the current and previous year’s turnover) within nine months after the end of the financial year, that is, the adjustment must be made in the VAT201 return <u>submitted</u> at the latest nine months after the financial year-end.

N8	This formula may only be used in the following circumstances: • If the method is fair and reasonable to the municipality's business activities. It is the municipality's responsibility to first determine this. If the method is not fair and reasonable, it is the municipality's further responsibility to approach the Commissioner for an alternative method.³ The Commissioner is unable to retrospectively approve an alternative apportionment method and will only approve the method from a prospective date or such other date falling within the limitations set out in proviso (iii) to section 17(1). • The municipality submits to VATRulings@sars.gov.za the following information on an annual basis at the time the annual adjustment referred to in N7 is reflected in the VAT201 return: ➤ The municipality's name ➤ VAT registration number ➤ Apportionment method and formula used ➤ Apportionment ratio for the year. The first time that this formula is applied, the method and apportionment ratio for the past three (3) years must be submitted.
N9	A grant that is received partly for taxable purposes and partly for non-taxable purposes must be attributed accordingly. For example, if 70% of a grant is for subsidising the taxable supply of water and electricity to customers, and 30% is for subsidising the municipality's exempt public transport business, the grant amount will have to be split into its respective taxable and non-taxable components in accordance with section 10(22). In this example, 70% of the grant amount will be subject to VAT at the zero rate and will be included in "a" in the formula. The remaining 30% of the grant will be applied for exempt purposes and will be included in "b" in the formula.
N10	Notwithstanding any permission which may have been granted by the Commissioner to allow a municipality to account for VAT on the payments basis under section 15(2)(a)(v), the amounts to be included in "a", "b", and "c" in the Formula for each tax period and for the annual adjustment contemplated in N7 are to be calculated on the invoice basis and in accordance with the principles set out in the Accounting Standards Board's Standard of Generally Recognised Accounting Practice (GRAP) on <i>Revenue from Non-exchange Transactions (Taxes and Transfers)</i>, commonly referred to as GRAP 23. In terms of GRAP 23, income from government grants and subsidies is only recognised when the conditions (if any) are met. Grant income will therefore only be included in the formula to the extent that such funds are reflected in the income statement of the municipality for the financial year concerned.

³ See the VAT Rulings Process Reference Guide for the process of application.

N11	It is the responsibility of a municipality to determine whether the supplies made by it are as principal or agent:⁴ • If functions have been formally assigned to a national or provincial municipality, the municipality makes these supplies as principal. As a result, these supplies fall within the ambit of the “enterprise” activities carried on by a municipality, provided the activity does not fall within the ambit of section 12. Any consideration charged, must be included in “a” in the formula if it relates to a taxable supply and in “b” in the formula if it relates to an exempt supply. • If a municipality is appointed as agent by provincial government, only the amount charged for the taxable supply of such agency service to the provincial government must be included in “a” in the formula. Any payment received as a result of the national or provincial government providing financial assistance to enable the municipality to carry out the formally assigned activity is regarded as a “grant” as defined. The inclusion in the formula will depend on whether the grant relates to the enterprise activities of the municipality (to be included in “a” in the formula) or otherwise (to be included in either “b” or “c” in the formula).
N12	The VAT incurred and paid for directly on the supply of goods or services associated with “unfunded mandates”, is regarded as being incurred in the course or furtherance of the municipality’s enterprise, provided the mandated activity is not exempt under section 12. The VAT may be deducted in full if the expenses concerned are incurred wholly for purposes of use, consumption, or supply in the course of making taxable supplies. Alternatively, the VAT may be deducted in part in accordance with the formula if the expenses concerned are incurred for mixed purposes.
N13	The deduction of input tax in all cases (including on mixed expenses) is subject to the documentary and other requirements set out in sections 16(2), 16(3), 17, and 20 being met.

5. Period for which this ruling is valid

This BGR applies with effect from all financial years commencing on or after 1 July 2025, and will apply until it is withdrawn, amended or the relevant legislation is amended. The apportionment formula as set out in Issue 3 of this BGR (the Issue 3 formula) is withdrawn effective from the aforementioned date.

6. Transitional rules

The Issue 3 formula applies to all financial years preceding those financial years commencing on or after 1 July 2025. If an alternative apportionment method has been approved for use by a municipality in a VAT ruling or VAT class ruling and the municipality regards the apportionment formula set out in this BGR to be fair and reasonable, that municipality can approach the Commissioner to have the VAT ruling or VAT class ruling withdrawn from the financial year commencing on or after 1 July

⁴ See BGR 74 “VAT Treatment of Certain Supplies of Goods or Services made by a Municipality to a National or Provincial Government” if you are uncertain whether the supply is made as agent or principal.

2025. The request for withdrawal must be submitted to **VATRulings@sars.gov.za** before the end of the financial year commencing on or after 1 April 2025.

The provisional ratio to be applied for the financial year commencing on or after 1 July 2025 may be based on the actual financial results of the preceding financial year using the Issue 3 formula. The adjustment to be made in the tax period, which ends no later than nine months after the end of the financial year that commenced on or after 1 July 2025, must be based on the actual financial results of such financial year using the apportionment formula set out in this BGR. In the event that a municipality determines its apportionment on a monthly basis, the municipality must apply the apportionment formula set out in this BGR from the first month of its financial year commencing on or after 1 July 2025. No adjustment after year-end is required.

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Annexure – Application of the exclusions and amendments to the apportionment formula as set out in paragraph 4 of the Ruling

Exclusions:

E1	Foreign exchange differences that do not form part of any hedging activities Municipalities may trade with customers or suppliers in currencies other than the South African Rand (ZAR). Due to the differing currencies used by the relevant parties for purposes of accounting records and financial transacting, foreign exchange differences must be accounted for to ensure that the accounting records of a municipality reflect the correct value of each transaction entered into. In these circumstances, the foreign exchange difference that is reflected is merely an accounting entry (refer also to the discussion in E2 below) to properly reflect the sale transaction and does not arise of any further activity by the municipality. As such, these foreign exchange differences must be excluded from the apportionment formula. The exclusion above is limited to a foreign exchange difference that is a natural consequence of a transaction and requires no additional effort from a municipality. Should a municipality decide to hedge its risk against foreign currency exposure, such decision would require the municipality to enter into another transaction and apply resources in developing the most effective hedging strategy whilst continuously developing and ensuring proper implementation of said strategy. Hedging foreign exchange transactions are used to address various risks identified (such as the risk of future or short-term cash flows, or the risk of income) and could take many forms, including forward contracts or options. In order to ensure that the use of resources and all transactions are properly reflected in the apportionment formula, any foreign exchange differences that result from a hedging transaction must be included in the formula. If a foreign exchange is hedged, the profit or loss on the underlying foreign exchange may not be set off against the profit or loss on the hedge as these are separate and distinct transactions from a VAT perspective, as explained above.
E2	Accounting entries, such as fair value adjustments, resulting in income reflected in the AFS to ensure compliance with relevant Regulatory Frameworks The GRAP requires certain value adjustments to be made in the accounting records of a person to ensure the true economic value of assets or liabilities are reflected in that person's AFS. From a VAT apportionment perspective, the value adjustments made are not income intended to be included in the formula – no actual income will be received by the municipality as the adjustment is merely a revaluation of an asset or liability at a specific point in time and not consideration for any activity as a result of a separate supply of goods or services. For this reason, any value adjustment made for GRAP purposes is excluded from the apportionment formula. Examples of accounting entries are – • revaluation of a transaction in foreign currency (also refer to E1 above, (excluding hedges); and • fair value adjustment of fixed and/or intangible assets.

E3	The supply of a capital asset The VAT incurred on capital expenditure is generally deducted as a once-off at the time when a municipality acquires the said asset (if a municipality is registered on a payments basis, deduction of the asset is made to the extent of payment). Although the asset is used throughout the municipality's operations, it is not one of the resources that, on an on-going basis, and forms part of the pool of expenses that are subject to the apportionment ratio. It is also accepted that municipalities are not in the business of selling off their capital assets on an on-going basis, as that would be un-business like and would severely influence the ability of the municipality to continue its operations. Therefore, the sale of capital assets is generally an extraordinary event that is not expected to occur continuously. Having regard to the extraordinary nature of the supply (such as a sale) of capital assets together with the possible substantial values attached to them, the inclusion of the income earned on the sale of capital assets in the apportionment formula would distort the apportionment ratio in that it would not fairly reflect the use of those resources to which the apportionment ratio is applied. It is worth highlighting that, due to the significant costs involved in acquiring capital assets, it may be necessary for municipalities to determine whether an alternative apportionment method is required for specific capital assets. The municipality must evaluate the specific circumstances and intended use of the capital asset to determine the most appropriate method for the specific asset and, if need be, apply for an alternative method. <i>What is a capital asset?</i> In short, a capital asset is an asset that enables a municipality to operate but is not the operation itself. Consider a municipality selling office furniture. To this municipality, the furniture enables the municipality to conduct its operations as it is not the mandate or purpose of a municipality to buy and sell office furniture for a profit. To the municipality, the office equipment is a capital asset. The circumstances of each case must be evaluated to determine the nature of a specific asset. The most important factor to consider is the intention of the municipality when acquiring and subsequently using the asset. As intention is a very subjective test, various factors must be used to determine and substantiate that intention. Some factors that may assist in determining whether an asset is capital in nature, is as follows: • Trading stock or consumables are not capital assets. • The asset is held with a certain degree of permanency. • Linked to the above, the asset is held for a lengthy period of time. Although this test is not conclusive on its own, it could be convincing when deliberated with other factors. • The type of asset is not commonly bought and sold by the municipality on a regular basis. • An asset which stays mostly intact, and which is rather used to produce wealth. The distinction between trading income and income of a capital nature is not a new concept in tax and has been the subject of various disputes and court cases over the years. Chapter 2 of the <i>Comprehensive Guide to Capital Gains Tax</i> provides in-depth examples and discussions on how to distinguish between income and capital. These principles can also be applied as guidance in determining whether an asset is capital in nature for VAT apportionment purposes.
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E4	Extraordinary income Extraordinary income is non-recurring income received due to exceptional circumstances that are unlikely to be repeated. From a VAT apportionment perspective, extraordinary income would have a significant impact on the quantum of income received by a municipality without affecting the normal expenses incurred year-on-year. The inclusion of such income in the apportionment formula would therefore severely distort the apportionment ratio as there would be a material fluctuation from one year to another whilst the mixed expenses, and the use these mixed expenses in the municipality's operation, would have remained unchanged. Based on the above, extraordinary income should be excluded from the apportionment formula. In order to give effect to this, "extraordinary income" is defined for VAT apportionment purposes as non-recurring income received due to exceptional circumstances that are unlikely to be repeated. An example of extraordinary income is dividends received as a result of a liquidation of a municipal entity (see also the discussion on dividends in A2 below). Examples of income that are NOT regarded as being extraordinary in the hands of a municipality: • Grant income • Dividends received from investments not as a result of the liquidation of a municipal entity
E5	The value of any goods or services supplied if input tax on those goods or services was specifically denied under section 17(2) A municipality is prohibited from deducting input tax on certain items listed in section 17(2). These include, amongst others – • goods or services acquired for purposes of entertainment; and • the acquisition of a "motor car" as defined in section 1(1). In both the above instances, municipalities would not generally supply entertainment or a "motor car" as defined (and are therefore allowed the deduction), and would therefore not normally buy and sell the items on a regular basis. The goods or services purchased would be of a capital nature and the subsequent supply these good or services would automatically be excluded from the apportionment formula as a result of their capital nature. In addition, it would be inequitable to include the income on the sale of such goods or services (or any indemnity payment received from such sale) if the municipality was originally disallowed (by legislation) any input tax deduction in relation to the sale.
E6	Change-in-use adjustments under sections 18, 18A, 18C and 18D A change-in-use adjustment adjusts the input tax deducted to reflect the actual use as opposed to the intended use of goods or services. Change-in-use adjustments should be excluded from the apportionment formula.

E7	Indemnity payments received as envisaged under section 8(8) to the extent that the indemnity payments relate to extraordinary income or capital assets Subject to certain exceptions, a municipality is deemed to make a supply of services upon receipt of an indemnity payment (or indemnification of a loss paid to a third party) from an insurer.⁵ Section 8(8) further deems that supply to be made in the furtherance of the municipality's enterprise. Any indemnity payment received as a result of a capital asset (such as an office building), or extraordinary income should not be included in the formula in keeping with the exclusions in E3 and E4.
E8	The value of municipal bonds issued as a manner of raising funds One of the methods of raising funds available to a municipality is to issue municipal bonds. Although this is not a very common manner for municipalities to raise long-term debt, certain municipalities have opted in recent years to issue municipal bonds for special projects, such as the acquisition of capital assets. Under section 2, the issuing of these instruments is deemed to be financial services, being an exempt supply under section 12(a). As this is regarded as being extraordinary, the income derived from the issuing of municipal bonds should not be included in the apportionment formula.
E9	Interest • <u>Earned from the municipality's current account(s) (meaning, the account used for day-to-day business operations)</u> It would be hard for any municipality to function without a bank account used every day to both receive and make payments. The municipality's intention when opening a transactional bank account is therefore never to earn the interest thereon, but rather to facilitate transactions within its business. The income in this account is generally as a result of payments received from third parties or customers as a result of trading activities and not investment activities by the municipality. As the interest rates on a transactional account is very low, businesses rarely hold money in a transactional bank account for earning interest. A municipality would rather transfer any excess funds to a call or similar account where the interest rates are much higher. The business decision to effect such transfer reflects a municipality's purpose of earning investment income in the form of interest. It is for this reason that any interest earned from a call or other investment account is included in the apportionment formula (refer also to A1). • SARS Interest.

Adjustments to the value of certain income streams included in the formula set out above:

A1	Interest, other than the interest excluded from the formula in E11 Investment activities are more often than not conducted by a municipality on a continuous basis, even though it might not be a municipality's main purpose. This often happens when a grant is received by a municipality for activities to be conducted over a certain period. The excess funds not to be used immediately are held in a savings account for later use, whilst also maximising the investment benefit from these excess funds. To ensure that the purpose for which the VAT incurred on goods or services is fairly reflected in the apportionment formula, one must have cognisance of the wholistic purpose of the entity, and all activities associated in achieving that purpose. For this reason, interest must be included in the formula.
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⁵ See section 8(8).

	It is however accepted that interest received is dependent on external factors, such as external interest rates. These external factors can result in material fluctuations in interest received from year to year even though a municipality's expenses in earning that interest have not significantly changed. For this reason, the interest to be included in the formula must be determined using the guidelines below: • <u>Investment interest</u> All investment activities of a municipality, whether investing in cash, equities or other instruments, must be appropriately reflected in the apportionment formula. As previously mentioned, it is acknowledged that the gross interest received is not reflective of how a municipality applies its resources. For this reason, any interest received from investments not otherwise specifically mentioned in the formula, must be included as follows: Interest received for the year × (prime rate – JIBAR) The interest received includes interest on any cash investment placed by a municipality, such as a savings, cash management or fixed deposit account. • <u>Debtor interest</u> Any municipality that has outstanding debtor accounts in their accounting records, have included the full value of the original supply in their apportionment formula. In order to ensure equity in the manner of which these income streams are included in the formula, the gross interest levied on the debtors' accounts must be included in the formula. This extends further to any "penalty interest" charged to a customer that does not fall under section 2(1)(f), to be included in "c" of the formula.
A3	Dividends The MSA allows municipalities to provide services through other entities, referred to as municipal entities. These entities are generally owned by one or more municipality. Furthermore, to ensure financial security, municipalities may also invest in various instruments both for the yield and financial growth associated with certain markets. Dividends, including dividends <i>in specie</i>, are the yield paid on investments in equity and similar instruments. In keeping with the principle of reflecting all investment activities in the formula as set out in A1, dividends received must be included in the formula to reflect the investment activity in said instruments (even though dividends are not consideration for any supply made by a municipality). The investment activity associated with the holding of investments (such as shareholdings held through an asset manager), must be fairly reflected in the formula. Having regard to the fact that an entity declares and pays dividends based on various requirements and factors (such as a group's dividend policy or economic and market conditions), it is accepted that the quantum of dividends does not fairly reflect the investment activity of holding the investments as capital assets. In addition, significant fluctuations may be experienced in the value of dividends declared from year to year. In order to appropriately reflect a municipality's investment activity in the formula, the value of dividends to be included in the formula must be determined as follows⁶: 3-year moving average of dividends received × (prime rate – JIBAR) • The 3-year moving average is determined by calculating the average of dividends received during the current financial year and two immediately preceding financial years. • If a municipality does not receive dividends during the current financial year, a 3-year moving average of the 3 preceding years may be used as proxy.

⁶ The reference to dividends received for purposes of determining the below, is the dividends received by a vendor for all investments collectively and does not refer to the receipt of dividends per investment held.

	• If a municipality receives no dividends for at least 2 out of the 3 years, a 5-year moving average must be used instead of the 3-year moving average where dividends were received for at least 2 of the 5 years. If a municipality has not received dividends for 2 out of the 5 years as required above, the municipality must approach the Commissioner for an alternative manner of determining a value to be included in the formula that appropriately reflects its investment activities. The application must comply with the time limitations set out in the proviso to section 17(1).
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