



Foreign Donor Funded Projects

VAT Reference Guide

Value-Added Tax

Preface

This reference guide provides information and guidelines regarding the value-added tax (VAT) treatment of foreign donor funded projects (FDFPs). This guide does not deal with all the legal detail associated with VAT and is not intended for legal reference. For more details on VAT in general, see the *VAT 404 – Guide for Vendors* (VAT 404).

All references to sections are to sections of the Value-Added Tax Act 89 of 1991 (VAT Act), unless the context indicates otherwise. The Tax Administration Act 28 of 2011 and the Income Tax Act 58 of 1962 are referred to as the “TA Act” and the “Income Tax Act” respectively. The terms “Republic” and “South Africa” are used interchangeably in this document as a reference to the sovereign territory of the Republic of South Africa, as set out in the definition of “Republic” in section 1(1). The information in this guide is based on the VAT Act and the TA Act as at the time of publishing, including the Taxation Laws Amendment Act 34 of 2019 and the Tax Administration Laws Amendment Act 33 of 2019.

The information in this guide is issued for guidance only. This guide is not an “official publication” as defined in section 1 of the TA Act and accordingly does not create a practice generally prevailing under section 5 of that Act. It is also not a binding general ruling under section 41B of the VAT Act.

All guides, interpretation notes, forms and returns referred to in this guide are available on the **SARS website**, and are as at the date of this publication.

For more information, assistance and guidance you may –

- visit the **SARS website**;
- contact your nearest SARS branch office; preferably after making an appointment via the **SARS website**;
- have a virtual consultation with a SARS consultant by making an appointment via the **SARS website**;
- contact the SARS National Contact Centre –
 - if calling locally, on 0800 00 7277; or
 - if calling from abroad, on +27 11 602 2093 (only between 8h00 and 16h30 South African time); or
- contact your own tax advisor or tax practitioner.

Comments regarding this guide may be e-mailed to **policycomments@sars.gov.za**.

Leveraged Legal Products SOUTH AFRICAN REVENUE SERVICE

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Contents

Preface.....	i
1. Background.....	1
PART I – INTRODUCTION TO A FOREIGN DONOR FUNDED PROJECT	2
2. Legislative history and development	2
3. Introduction to a foreign donor funded project.....	3
3.1 What is a foreign donor funded project?.....	3
3.2 Official Development Assistance Agreement.....	4
3.3 Implementing agency	5
PART II – VALUE-ADDED TAX REGISTRATION	7
4. Enterprise.....	7
5. Registration.....	8
5.1 Eligibility of a foreign donor funded project to register for VAT	8
5.2 Where and how must the implementing agency register?.....	9
5.3 What documents must be submitted with an application?.....	10
6. Accounting basis.....	11
PART III – VALUE-ADDED TAX TREATMENT OF FOREIGN DONOR FUNDED PROJECT TRANSACTIONS.....	12
7. Output tax.....	12
7.1 Calculation of output tax	12
7.1.1 Deemed supplies.....	13
7.2 Value of supply and consideration.....	15
7.3 Time of supply.....	16
8. Input tax and other deductions.....	16
8.1 What will qualify as input tax or a deduction?.....	16
8.2 Documentary requirements	17
8.3 How is a deduction made?.....	18
8.4 Period in which a deduction should be made.....	18
PART IV – DOCUMENTATION AND RECORD-KEEPING	19
9. Tax invoices.....	19
9.1 Introduction.....	19
9.2 What are the requirements for tax invoices?	19

10. Record-keeping.....	20
PART V – COMPREHENSIVE EXAMPLES.....	22
Structure 1: Basic foreign donor funded project structure.....	22
Structure 2: Multiple implementing agencies for one project.....	23

1. Background

The South African government may enter into international donor funding agreements with foreign governments or other international entities in terms of which goods or services must be supplied for the benefit of people in South Africa (SA). The international donor funding agreements, also commonly referred to as Official Development Assistance Agreements (ODAA), are pursuant to section 231(3) of the Constitution of the Republic of South Africa Act 108 of 1996 (the Constitution) and the ODAA stipulate that such funding cannot be used to pay for any taxes imposed under South African Law. The project under which this agreement is facilitated is known as an FDFP.

In order to give effect to the requirement stipulating that such funding cannot be used to pay for any taxes imposed under South African Law, the South African VAT legislation was designed in such a way that –

- no VAT is levied on the international funding received; and
- South African VAT charged to the FDFP on the acquisition of goods or services or VAT paid by the FDFP on the importation of goods, for purposes of the project, may be deducted as input tax.

Recent legislative changes resulted in a significant change in the administration of FDFPs for VAT purposes. The main difference between the old and new legislation is with reference to the “**person**” who is required to register for South African VAT.

The purpose of this reference guide is to provide certainty to taxpayers on the VAT treatment of FDFPs implemented by an implementing agency. The guide is divided into five parts:

- Part I sets out the development of the South African VAT system with regard to FDFPs and introduces the concept of an FDFP together with the different persons involved.
- Part II provides guidance on the VAT registration requirements and procedures of FDFPs registered by SARS as vendors on or after 1 April 2020.
- Part III sets out the VAT consequences of any transactions entered into by an implementing agency for the purpose of an FDFP.
- Part IV deals with the various documentary and record-keeping requirements set out in the VAT Act.
- Part V contains comprehensive examples illustrating the various VAT principles discussed in this guide.

PART I – INTRODUCTION TO A FOREIGN DONOR FUNDED PROJECT

2. Legislative history and development

The concept of FDFPs was first introduced formally in the VAT Act during 2006.¹ Before this date, FDFPs were dealt with by way of special arrangements made by the Commissioner under section 72. In order to cater for the “non-payment of any taxes” clauses in international donor funding agreements, a channel for refunds was created within the VAT system. This was done by regarding the FDFP to be a person for VAT purposes and including the activities of that person (that is, the FDFP) in the definition of “enterprise”. The FDFP was deemed to make a taxable supply of services to the foreign donor in respect of the international funding received from the international donor, which was taxable at the rate of 0%. The VAT incurred on acquisitions made for purposes of the project was then claimable by way of the input tax provisions in VAT legislation.

The effect of the above was that the FDFP, being a “person”, was responsible to register for VAT and ensure that the project complies with all the requirements of the VAT Act. The challenge that ensued was the difficulty to identify the “person” who must correctly register for VAT purposes and that will qualify for the VAT relief (that is, taxable supplies at the zero rate and unlocking of all input tax).

In 2007, a clarification was made to the definition of an “FDFP” to clarify that the relief should only be applied to an international donor funding agreement entered into by the South African government under section 231(3) of the Constitution if the said agreement specifically contains clauses preventing the payment of taxes.

Legislative amendments made in the Taxation Laws Amendment Act 34 of 2019, made further changes to the legislative concept of an FDFP as follows:

- Firstly, an FDFP was linked to an ODAA, to be approved by the Minister of Finance for purposes of the definition of an “FDFP”, and a definition of the “implementing agency” was introduced. This amendment provided clarity as to the level or extent to which a project can qualify as an FDFP.
- Secondly, the registration regime of an FDFP was significantly changed. An FDFP is no longer included in the definition of a “person” for VAT purposes. Rather, the implementing agency of the FDFP, being a juristic person, is required to register as a vendor for VAT purposes. Each FDFP complying with the definition in section 1(1) is regarded as separate enterprises for VAT purposes and must, where necessary, register as a branch of the main VAT registration of the legal person appointed as the implementing agency. The legal person responsible for the FDFP complying with all the requirements of the VAT Act is therefore the implementing agency.

The new legislation is effective from 1 April 2020. However, various FDFPs were registered as vendors under the old FDFP VAT legislative framework. Due to the limited duration of an FDFP, it would be impractical to require all currently registered FDFPs to change their VAT registration to that of a branch of the implementing agency. For this reason, the new legislation only applies to VAT registration applications received by SARS on or after 1 April 2020. All FDFPs registered as VAT vendors under the old regime will continue under the said regime until the project has been finalised.

¹ Refer to section 101(c) of the Revenue Laws Amendment Act 31 of 2005.

This means that, if an FDFP ought to have registered before 1 April 2020 but failed to do so, and only applies for VAT registration after 1 April 2020, the new registration rules will apply to the FDFP VAT registration, even though the date of registration may be backdated.

The following terminology is used in this document, in line with the policy construct of the new legislation, unless indicated otherwise:

- **“Implementing agency”** is the legal person that is contractually responsible for the operation, administration, implementation and management of the FDFP.
- **“Main VAT registration”** is the enterprise activities conducted by a vendor, which is also an implementing agency that does not relate to the operation, administration, implementation and management of the FDFP.
- **“FDFP VAT branch”** is the separate VAT registration in relation to FDFP activities conducted by the implementing agency, generally as a branch of the main VAT registration, and which excludes all enterprise activities of the implementing agency that is not in relation to the operation, administration, implementation and management of an FDFP.

3. Introduction to a foreign donor funded project

3.1 What is a foreign donor funded project?

An “FDFP” is specifically defined in the VAT Act to be **a project** complying with all of the following:

- The project must be established under an ODAA to supply goods or services to beneficiaries. It is important that the beneficiaries referred to in this definition are the people of South Africa.
- The government of South Africa must be a party to the ODAA.
- The ODAA under which the project was established was tabled in the National Assembly, as contemplated in section 231(3) of the Constitution.
- The ODAA agreement must stipulate that the funding cannot be used to pay for any taxes imposed under South African Law.
- The Minister of Finance must have approved the project to be an FDFP for VAT purposes (only applicable to FDFP VAT registrations on or after 1 April 2020).

Before 1 April 2020, the definition of an “FDFP” referred to an international donor funding agreement. In context, the reference to an international donor funding agreement was always intended to be an agreement facilitating ODAA funding. Practically and operationally, that is also how the definition of an “FDFP” was applied. The legislative amendments did not change the definition of an “FDFP” in this regard but merely gave effect to the original policy intent.

3.2 Official Development Assistance Agreement

The definition of an “FDFP” in the VAT Act relies on the concept of an ODAA. In essence, an ODAA is –²

“government aid that promotes and specifically targets the economic development and welfare of developing countries”.

Applied in the context of South Africa, the Policy Framework on ODAA as published by National Treasury³ regards an ODAA to be –

“[o]fficial resource flows from the international donor community to South Africa in the form of grants, technical co-operation and financial co-operation, where the South African Government is held at least partially responsible or accountable for the management of such resources”.

An ODAA identifies South Africa’s funding requirements as well as the foreign organisations providing the said funding, and is an agreement entered into by the South African government in either of the following ways:

- An overarching agreement with a foreign government, which identifies certain foreign donors that are either specifically listed or defined in the ODAA. The foreign government, for the purposes of this document, includes the United Nations and European Union and is generally the main or sole funder of the foreign donors falling under the ODAA.
- An individual agreement with a foreign donor organisation that forms part of a foreign government, generally for a specific project or purpose. If the foreign donor organisation does not in some way form part of or is mainly or solely funded by the foreign government, the agreement will not qualify as an ODAA.

Notwithstanding the different types of ODAA as discussed above, an ODAA will always stipulate that any funding received under the ODAA cannot be used to pay for any taxes imposed under South African Law.

An additional sub-agreement (or sometimes referred to as the implementing agreement) is generally entered into that flows from the ODAA to allocate funding to a specific project, being a project agreement. This agreement can be between the foreign donor and either the South African government, being a specific department, or the implementing agency directly. If such sub-agreement is between the foreign donor and a government department, it is quite common for the said department to sub-contract its responsibilities to a different institution, being the implementing agency.

Being a party to the ODAA, the South African government accepts responsibility for how the funds given by the foreign donors are used. This means that the South African government is responsible to ensure that the funds are used by the implementing agencies of the respective projects in accordance with the ODAA, read with the funding agreements entered into between the implementing agency and the foreign donor. The South African government must further ensure that the funds received, and the purpose for which the funds are used, are aligned to the development and reconstruction priorities established by it. In this regard, the South

² Definition given to an ODAA by the Organisation for Economic Cooperation and Development (OECD) Development Assistance Committee (DAC), www.oecd.org/dac/financing-sustainable-development/development-finance-standards/What-is-ODAA.pdf [Accessed 25 August 2022].

³ *Policy Framework and Procedural Guidelines for the Management of Official Development Assistance: 1st Edition*, published October 2003.

African government is held accountable for the misuse of the funds, including where the funds are being used to pay for any taxes imposed under South African Law

All ODAs must be tabled in the National Assembly as contemplated in section 231(3) of the Constitution. The information regarding the tabling is subsequently published by National Treasury in the Announcements, Tablings and Committees documents. National Treasury is the relevant government department keeping record of all qualifying ODAs. For accountability, National Treasury must be informed of all projects receiving funds from foreign donors under an ODA.

For any further information regarding ODAs and the policies surrounding such, please refer to the *Policy Framework and Procedural Guidelines for the Management of Official Development Assistance: 1st Edition*, published by National Treasury during October 2003, or contact National Treasury (details available at www.treasury.gov.za).

3.3 Implementing agency

The implementing agency is contractually liable for the successful completion of the project and to provide relevant reports to the foreign donor. This means that the implementing agency is the legal person that has entered into, also being a signatory to, an agreement with the foreign donor or the South African government and is the person specifically identified in the agreement as being the implementing agency.

In this regard, an “implementing agency” is specifically defined for VAT purposes as one of the following persons to implement, operate, administer or manage an FDFP:

- Any national, provincial or local sphere of government of the Republic. This includes amongst others, any municipality or department of national government, such as the Department of Trade and Industry.
- Any institution or body established and appointed by a foreign government as contemplated in section 10(1)(bA)(ii) of the Income Tax Act. The institution or body must therefore have been appointed by the foreign government to perform its functions under an ODA that is bound under section 231(3) of the Constitution and the ODA specifies that all receipts and accruals of the institution or body must be exempt from income tax.
- Any person that has entered into a contract directly with any party specified above. This, however, does not include a sub-contractor or supplier of goods or services to the project, but rather applies to a person responsible for the management and facilitation of a project, or part thereof.

The implementing agency is responsible for the accounting of the receipt of funding and distribution of such funding received from the foreign donor. In this regard, it is generally a requirement under the ODA for the foreign donor funding to be kept separate from the general funds of the implementing agency. Consequently, for VAT purposes, the implementing agency, if already registered for VAT, is required to register separate VAT branches to account for each FDFP project. The implementing agency is then the legal person that enters into contracts with suppliers for the acquisition of goods or services necessary for the project.

An example of an implementing agency is a medical institution registered for VAT (for the purpose of supplying medical services) that has entered into an agreement with the Department of Health to provide the service of implementing a qualifying FDFP. From a VAT registration perspective, the activity of supplying medical services constitutes enterprise activities of the medical institution's main VAT registration, whereas the medical institution's activities in operating, administering, implementing and managing the FDFP constitutes the enterprise activities of the FDFP VAT branch.

On the other hand, a construction company that has entered into a contract with the Department of Health to supply tiling services as part of building a hospital (which forms part of a qualifying FDFP) but which construction company is not responsible for the implementation of the project, is not an implementing agency. The construction company merely supplies a service to the Department of Health.

Refer to paragraph Part V for a comprehensive example that illustrates the relationship between an implementing agency, its main VAT registration and the FDFP VAT branch.

PART II – VALUE-ADDED TAX REGISTRATION

This Part deals with the legislative and operational rules governing FDFP VAT branch applications submitted to SARS on or after 1 April 2020.

4. Enterprise

A person can only register for VAT if that person is carrying on an enterprise. An “enterprise” is defined to be any enterprise or activity carried on continuously or regularly in or partly in the Republic and in the course or furtherance of which goods or services are supplied to another person for a consideration.

The activities of an implementing agency carried on in the course of implementing, operating, administering or managing an FDFP are specifically included in the definition of “enterprise”. This allows the implementing agency to register its activities for purposes of an FDFP in order to make use of the refund mechanism contained in the VAT Act.

Section 50 deems the activities of an implementing agency in implementing, operating, administering and managing an FDFP to be a separate enterprise from any other enterprise activities carried on by the implementing agency. For this reason, it is important that the implementing agency distinguishes between any activity carried on by it for its own benefit (meaning its own enterprise activities such as making supplies of goods or services for a consideration) and those activities relating to the actual running of the FDFP. In this regard, it is common for the implementing agency (in capacity of its own enterprise activities housed in the main VAT registration) to supply goods or services to the FDFP enterprise (also referred to as the FDFP VAT branch for purposes of this guide).

In order to sufficiently distinguish between the activities of the various enterprises conducted by it, the implementing agency is required to maintain separate accounting records for each FDFP for which it is responsible as well as its own enterprise activities.

The enterprise activities conducted by the FDFP VAT branch can only ever be those activities of the project to the extent that the project complies with the definition of an “FDFP”. This means, that should a project be part-funded by any other means, whether as a result of grants received from the South African government or supplies made of goods or services, such activities (to the extent of the funds received not being under an ODAA) do not form part of the enterprise of the FDFP VAT branch. These activities would rather form part of the enterprise activities of the implementing agency’s main VAT registration.

See the *VAT 404 – Guide for Vendors* and paragraph 5.1 of Interpretation Note 70 “Supplies made for no consideration” for further details.

5. Registration

5.1 Eligibility of a foreign donor funded project to register for VAT

The implementing agency plays a pivotal role in the VAT registration and administration of an FDFP. The implementing agency falls within the definition of a “person”. As a result, the implementing agency is liable to register for VAT in respect of any enterprise (including that which relates to an FDFP) carried on by it (refer to 4).

Generally, a person is required to register when –

- the value of taxable supplies made by it has exceeded R1 million within any 12-month period; or
- it has entered into written contracts creating an obligation for that person to make taxable supplies with a value exceeding R1 million within a 12-month period.

The purpose of registering the activities of an implementing agency in operating, administering, implementing and managing an FDFP is to enable the refund of any VAT incurred on project expenses falling under the ODAA, which requires that project funds are free from any taxes imposed.

The implementing agency must apply to the Commissioner for its activities in relation to an FDFP to be registered for VAT purposes. Should the implementing agency already be a registered VAT vendor, the enterprise activities of the implementing agency in relation to an FDFP must be registered as a separate branch of the implementing agency’s main VAT registration.⁴ Should the implementing agency not be a registered vendor in its own right (for instance, the implementing agency is prohibited from registering for VAT or does not conduct an enterprise for VAT purposes), the activities of an implementing agency relating to that of an FDFP must be registered as the main VAT registration. Any further FDFPs managed by the implementing agency will then be registered as separate branches of such main VAT registration (including sub-agreements or implementing agreements that are entered into with different donors).

The implementing agency is required to apply to the Commissioner for each FDFP that it administers, in order to register the activities of operating, implementing, administering and managing each FDFP as a separate branch of the implementing agency’s main VAT registration. The policy intent is clearly set out in the amended legislation that multiple branch registrations are contemplated so that each FDFP administered by the implementing agency is registered separately from the implementing agency’s other enterprise activities (being the main VAT registration) as well as separate from each other. Therefore, vendors that have multiple FDFPs will not be able to account for all of their different FDFP activities under a single FDFP branch registration.

⁴ Section 50(2A).

Consequences of branch registration

The following apply when registering the FDFP VAT branch as a separate branch from the implementing agency's other enterprise activities:

- The FDFP VAT branch must retain the same tax periods and accounting basis as the implementing agency's main VAT registration.
- The enterprise of the FDFP VAT branch is deemed to be separate from the implementing agency's other enterprise activities. This means that the implementing agency is responsible for submitting separate VAT returns (VAT201) and make payments to SARS for each branch (if applicable) as well as its main VAT registration.
- In the event that the implementing agency fails to adhere to the requirements under the VAT Act, such as the submission of returns for each tax period or the issuing of tax invoices, the implementing agency bears the ultimate compliance responsibility.

Future registration

Any vendor that fails to register for VAT may, under section 23(4)(b), apply to the Commissioner to allow such vendor to register for VAT from a future date. This is a discretion afforded to the Commissioner to consider the specific circumstances and, based on various factors such as financial loss to the fiscus or abuse of legislation, the Commissioner may grant permission to a vendor to register only from a date regarded as equitable.

One of the most important aspects of an ODAA is that the agreement specifically requires that the project expenses do not include any taxes. Should it be found by the foreign donor that the agreement was breached in this regard, it may result in penalties and/or loss of funding. For this reason, it is unlikely that the Commissioner will allow an FDFP VAT branch to register for VAT only from a future date, meaning a date after the commencement of the project, as the VAT registration process is the only mechanism available to refund the VAT incurred for purposes of the project.

5.2 Where and how must the implementing agency register?

The FDFP VAT branch should be registered at a SARS branch office. In this regard, an authorised person must go to the nearest SARS branch, together with all the relevant supporting documentation, and perform the application in person. This means that, in the case of the implementing agency being a sole proprietor, the individual concerned must go to the branch and assist with the registration in person, or in the case of the implementing agency being any other person such as a partnership, company or trust fund, the relevant representative vendor is the responsible or authorised person. Alternatively, an authorised registered tax practitioner may appear in person on behalf of the implementing agency (in such cases, the application must be accompanied by a Power of Attorney form).

Note that the use of eFiling for registering an FDFP VAT enterprise as branch of the implementing agency is not currently available. During the lockdown period, as commissioned by the President of South Africa under section 27 of the Disaster Management Act 57 of 2002, read with the Regulation published on 18 March 2020,⁵ any VAT registration applications for FDFPs must be emailed to **FDFP@sars.gov.za** together with all the information listed in **5.3** below.

⁵ *Government Gazette* 43107.

The trading name of the FDFP VAT branch must be the name of the project in accordance with the relevant agreement. If the implementing agency is not registered as a vendor and the activities of an implementing agency relating to that of an FDFP must be registered as the main VAT registration, the VAT101 form to be completed must reflect the juristic name of the implementing agency as the entity's "Registered Name" and the name of the FDFP (being the project) as the "Trading Name".

Please refer to the *VAT-REG-02-G01 – Guide for Completion of VAT Registration Application Forms* for a comprehensive explanation as to how to complete the VAT102e form.

5.3 What documents must be submitted with an application?

It is very important that the correct documents are submitted with the application to register; to avoid a delay in obtaining the VAT registration number. See the *VAT-REG-02-G01 – Guide for Completion of VAT Registration Application Forms* for a comprehensive list of such documents.

Specific to the VAT registration of an FDFP VAT branch, the following additional documents must be submitted upon application:

- Either the –
 - ODAA agreement between the applicable country and South Africa, reflecting the name of the implementing agency; or
 - the agreement between the implementing agency and the foreign donor or government department.
- A signed letter with a unique reference number from National Treasury confirming the approval that the project is an FDFP for VAT purposes (the process for obtaining this confirmation is set out below).
- Certified copy of the representative vendor's identity document (ID).
- If the representative vendor of the FDFP VAT branch is not the same as that of the implementing agency's main VAT registration, the letter of appointment of the representative vendor.
- Proof of the implementing agency's business address not older than three months.
- Proof of the representative vendor's residential address not older than three months.
- Original letter from the bank on the bank's letterhead with an original bank stamp reflecting the date the account was opened or a bank statement with the original bank stamp. In this regard, the legal name reflecting on the bank statement will be that of the implementing agency.

Approval of a foreign donor funded project by National Treasury

The Commissioner must be satisfied that the project complies with all the requirements of an FDFP before considering the VAT registration application for the FDFP submitted by the implementing agency. In this regard, the definition of an "FDFP" requires the Minister of Finance to approve the project as an FDFP for VAT purposes.

Before submitting the VAT registration application to SARS, the implementing agency must approach National Treasury to obtain a letter (on a National Treasury letterhead, signed by an authorised person and containing a unique reference number) confirming the approval that the specific project falls under an ODAA. The request must be emailed to **FDFP@treasury.gov.za**, clearly indicating what is required, and be accompanied by the agreement between the implementing agency and the foreign donor or government department.

6. Accounting basis

The South African VAT system generally requires vendors to account for VAT on the basis of invoices being issued or received. This method of accounting is referred to as the “invoice basis” or “accrual basis”.

Under this method of accounting vendors must generally account for the full amount of VAT included in the price of the goods or services supplied in the tax period in which the time of supply has occurred. This applies to the output tax liability on cash and credit sales as well as the input tax that may be deducted on cash and credit purchases.⁶ According to the general time of supply rule, a supply occurs at the earlier of the time –

- that an invoice is issued; or
- any payment is received by the supplier.

Vendors must therefore account for the full amount of output tax on any supplies made in the tax period, even where payment has not yet been received from the recipient. Similarly, the full amount of input tax may be deducted on supplies received in the tax period, even where payment has not yet been made.

The VAT Act allows certain vendors to account for VAT on a payments basis (that is, declare output tax to the extent of payment received and deducting input tax to the extent of payment made). This allowance is however only available to certain persons (such as a municipality or water board) complying with strict requirements.⁷

In the event that the FDFP VAT enterprise is registered as a branch of the implementing agency’s other enterprise activities (main VAT registration), the accounting basis of the FDFP VAT branch must follow that of the main VAT registration. This means that should the implementing agency be a person that qualifies to account for VAT on the payments basis and has obtained the relevant approval from the Commissioner, the FDFP VAT branch will also be registered for VAT on the payments basis.

⁶ Note that the input tax deduction is subject to the documentary requirements under section 16(2).

⁷ Refer to section 15.

PART III – VALUE-ADDED TAX TREATMENT OF FOREIGN DONOR FUNDED PROJECT TRANSACTIONS

Regardless of whether an implementing agency has applied for registration with the Commissioner for the activities of operating, implementing, administering and managing an FDFP before or after 1 April 2020, the VAT consequences of supplies deemed to be made and goods or services acquired have not changed.

Before 1 April 2020, the FDFP was a “person” for VAT purposes. Subsequent to the legislative amendments, with the effective date being 1 April 2020, the FDFP VAT branch is deemed to be carrying on a separate enterprise from that of the implementing agency’s main VAT registration. In both these regimes the FDFP, whether being its own person or a branch of the implementing agency’s main VAT registration (meaning the FDFP VAT branch), is the vendor for VAT purposes that supplies and receives goods or services and therefore remains responsible for declaring the relevant VAT in its VAT return for the correct tax period. Below is a brief summary of the most pertinent provisions that may impact the VAT liability or refund of the FDFP VAT branch.

7. Output tax

7.1 Calculation of output tax

Output tax is generally levied at the standard rate on any supply made by a vendor in the course or furtherance of its enterprise, unless an exemption or special rule applies. The term “supply” is widely defined in the VAT Act to include performance under any sale, rental agreement and instalment credit agreement. It also includes all other forms of supply, whether voluntary, compulsory or by operation of law, irrespective of where the supply is effected, and includes any derivative of the term.

The VAT Act makes provision for certain supplies to be subject to VAT at the rate of 0%, (zero-rated supplies).⁸ These supplies are, together with standard-rated supplies, referred to as taxable supplies. Non-taxable supplies are supplies made that are not subject to VAT. These supplies are either specifically exempt from VAT⁹ (an example would be the supply of financial services) or do not fall within the scope of the VAT Act (such as supplies made by a person that is not a vendor).

The enterprise activities of the FDFP VAT branch and that of the implementing agency’s main VAT registration are separate for VAT purposes. Any supplies of taxable goods or services between the separately registered enterprises must be charged with VAT at the appropriate rate and accounted for on the relevant VAT return covering that period. This means that the implementing agency is required to declare the relevant output tax under the main VAT registration and is entitled to deduct the input tax under the FDFP VAT branch. Normal VAT principles must be applied to determine the VAT rate applicable to the specific supply.

⁸ Refer to section 11.

⁹ Refer to section 12.

7.1.1 Deemed supplies

A vendor may sometimes be required to declare an amount of output tax even though the vendor has not actually supplied any goods or services. Deemed supplies will generally attract VAT at either the standard rate or zero rate. Below is a discussion of those deemed supplies generally associated with an FDFP VAT branch.

Foreign donor funding

An FDFP VAT branch is deemed, under section 8(5B), to supply a service to a foreign donor to the extent of foreign donor funds received from the foreign donor. The supply of the said service is taxable at the rate of 0% under section 11(2)(q), subject to the necessary documentary proof being obtained as required under section 11(3). This means that, even though the deemed supply to the foreign donor is regarded as being taxable from a VAT perspective, the amounts received from the foreign donor would be subject to VAT at the zero rate.

Interpretation Note 31 (Issue 4), dated 9 March 2016, sets out, under Item Q, the documentary proof required to zero-rate the deemed supply by the FDFP to the foreign donor, to be the following:

- The FDFP VAT branch (grantee's) copy of the zero-rated tax invoice.
- A copy of the agreement or other applicable documentation or correspondence in respect of which foreign donor funding was received.

Example 1 – Foreign donor funding: Once-off payment

Facts:

Company Z, a vendor, is the implementing agency of Project Y, which qualifies as an FDFP. Company Z has duly registered Project Y as a branch for VAT purposes. Company Z has entered into an international donor funding agreement with Foreign Donor X in terms of which Foreign Donor X would donate R1 000 000 as a once-off amount on 1 July 2020 towards the implementation and completion of Project Y. This international donor funding agreement falls under an ODAA duly tabled at the National Assembly.

What is the output tax liability of Company Z and Project Y respectively?

Result:

Project Y is registered as an FDFP VAT branch that is deemed to make a supply to Foreign Donor X to the extent of the R1 000 000 received from Foreign Donor X. The output tax payable on the amount received is calculated as follows:

- $R1\ 000\ 000 \times 0\% = R0$

Company Z is merely the implementing agency and the R1 000 000 received in relation to Project Y has no VAT consequences to Company Z.

Example 2 – Foreign donor funding: Instalments

Facts:

Consider the same facts as in **Example 1**. However, Foreign Donor X will make payments towards Project Y as follows:

- 1 July 2020 – R500 000
- 1 September 2020 – R300 000
- 1 November 2020 – R200 000

What is the output tax liability for Project Y?

Result:

Project Y is registered as an FDFP VAT branch that is deemed to make a supply to Foreign Donor X only to the extent of the R1 000 000 received from Foreign Donor X. The time of supply as well as the output tax payable on the amounts received would be calculated as follows:

- 1 July 2020 – R500 000 × 0% = R0
- 1 September 2020 – R300 000 × 0% = R0
- 1 November 2020 – R200 000 × 0% = R0

Ceasing of the foreign donor funded project enterprise

An FDFP is a project with a limited period. As a result, as soon as the project ends, the FDFP VAT branch ceases to carry on any further enterprise activities and is required to deregister for VAT purposes. Any goods or rights forming part of the FDFP VAT branch's enterprise assets are deemed to be supplied in the course or furtherance of the FDFP VAT branch's enterprise immediately before the FDFP VAT branch ceases to be a vendor, subject to certain exceptions. The deemed supply of these assets by the FDFP VAT branch is not automatically subject to VAT at the zero rate but are subject to VAT in accordance with normal VAT principles.

After completion of the project, any remaining cash, whether capital, interest or VAT refunds, must be refunded to the foreign donor unless the agreement specifies otherwise. In this regard, agreements may require any remaining assets after completion of the project to be donated to a non-profit organisation before VAT deregistration. Should this be the case, there will be no VAT consequences on the donation of the assets. It must, however, be considered whether a section 18 adjustment is required when the purpose for which the asset is used has significantly changed. Should the implementing agency keep the asset after the project has finalised, to be used in the enterprise activities housed in its main VAT registration, the deemed supply by the FDFP will be subject to normal VAT principles.

Insurance indemnity payments

Any insurance pay-outs made relating to short-term insurance claims in connection with the FDFP VAT branch's enterprise activities, are subject to VAT based on normal VAT principles, meaning that such pay-outs are generally standard-rated. This relates to, for example, insurance pay-outs received for damaged or stolen stock.

See the *VAT 421 – Guide for Short-Term Insurance* and BGR 14 "VAT Treatment of Specific Supplies in the Short-Term Insurance Industry" for more information in this regard.

Example 3 – Insurance indemnity payment

Facts:

Company B is the implementing agency of Project X, qualifying as an FDFP and duly registered for VAT as a branch of Company B's main VAT registration. Company B purchased an asset for the purpose of the project, registered the asset and obtained insurance on the asset in the name of Company B. Input tax was deducted in the VAT registration of Project X (being the FDFP VAT branch) on both the acquisition of the asset and the insurance obtained thereon (subject to all tax invoices complying with the requirements as discussed in 9.2 below).

The asset was stolen during July 2020 and the insurer pays R25 000 on 1 August 2020 as compensation for the loss.

What are the VAT consequences for Company B and Project X respectively?

Result:

The indemnity payment is deemed to be received in the course of Project X's enterprise (being the activities of the project qualifying as an FDFP). Project X is therefore required to account for output tax in the August 2020 return. The VAT is calculated by applying the tax fraction to the amount received, that is, $R25\ 000 \times 15 / 115 = R3\ 620,87$.

7.2 Value of supply and consideration

The consideration for a supply will normally be equal to the amount of money that is payable for the supply. The consideration for a supply is represented by the value plus the VAT charged.¹⁰ The term "consideration" includes payment made or to be made, whether in money or otherwise. In cases where the consideration is not in money, the consideration will be the open market value of the consideration.¹¹ The open market value includes the VAT element.

The value of supply for the deemed supply made by the FDFP VAT branch to the foreign donor is contained in the deeming provision (refer also to 7.1.1), meaning that the value of the deemed supply made by the FDFP VAT branch to the foreign donor is equal to the consideration, or money, received from the foreign donor.

Note that although section 10 of the VAT Act is titled "Value of supply", some of the subparagraphs in that section prescribe the *consideration* for the supply instead of the *value* of the supply. Specific value of supply rules apply to certain transactions. See the *VAT 404 – Guide for Vendors* for more details in this regard.

¹⁰ Section 10(2).

¹¹ Section 10(3). See also section 3.

7.3 Time of supply

Generally, the time of supply is the earlier of the time an invoice¹² is issued by the supplier (or the recipient in certain instances¹³), or the time any payment of consideration is received in respect of that supply.

The type of arrangement regarding the payments made by the foreign donor will determine when the FDFP VAT enterprise registration is required to levy and account for VAT (albeit at the rate of 0%), as well as when tax invoices must be issued (refer also to 7.1.1 in this regard). These details should be specified in the project agreement.

Specific time of supply rules apply to certain transactions. For example, section 9(3)(b) provides that services supplied under an agreement or law that provides for periodic payments, are deemed to be successively supplied and each successive supply is deemed to take place when a payment becomes due or is received, whichever is earlier. See the *VAT 404 – Guide for Vendors* for more details in this regard.

8. Input tax and other deductions

8.1 What will qualify as input tax or a deduction?

Generally, the VAT charged by a vendor to another vendor on any goods or services acquired for the business will qualify as input tax in the hands of the recipient vendor. It is important that input tax is only deducted insofar as the supplies are used for the purposes of making taxable supplies in the course or furtherance of the enterprise.

A consequence of the deemed supply made by the FDFP VAT branch to the foreign donor being taxable (even though taxable at the rate of 0%), is that the FDFP VAT branch is able to deduct all the VAT incurred that relates to the FDFP as input tax. The deduction of input tax gives effect to the policy intent of the legislation of not subjecting approved FDFPs to tax. This includes any VAT incurred on expenses such as the acquisition of motor cars and entertainment which are usually denied.¹⁴

It is important to highlight that the enterprise relating to the implementation and day-to-day operational running of the project is that of the FDFP VAT branch. As a result, any input tax incurred in the course or furtherance of the project must be deducted by the FDFP VAT branch and not under the implementing agency's main VAT registration. It must further be highlighted that VAT incurred may only be deducted as input tax to the extent that the project qualifies as an FDFP. This means that, where a project is only part-funded by the foreign donor, it is only that part of the project that is entitled to deduct input tax under the rules set out in this guide. The part of the project funded by another person (for example, the South African government), being the extent the project does not qualify as an FDFP, will be subject to the general principles of VAT.

No VAT may be deducted when goods or services are acquired for private purposes, exempt supplies or other non-taxable purposes.

¹² This is any document notifying you of an obligation to make payment and is not necessarily a tax invoice.

¹³ For example, when the conditions for recipient-created invoicing by the recipient are met.

¹⁴ See section 17(2A).

8.2 Documentary requirements

The relevant documentary proof must be held by the vendor at the time that a deduction is made. For example, in the case of standard-rated supplies, a valid tax invoice, debit note or credit note or other prescribed documentation must be held.¹⁵ In the case of second-hand goods, records must be maintained by the vendor deducting the input tax as per form VAT264 and section 20(8).¹⁶

As the FDFP VAT branch falls under the legal name of the implementing agency, which is also the VAT registered name of the implementing agency's main VAT registration, the name reflected on the tax invoice issued by the supplier in relation to goods or services supplied for purposes of the project, will generally reflect the name and other details of the implementing agency's main VAT registration as recipient of the supply. This should not impact the deductibility of input tax by the FDFP VAT branch as long as –

- the name of the project (assumed also to be the VAT registered name of the FDFP VAT branch) is also reflected on the face of the tax invoice or other documentation used; and
- the VAT registration number of only the FDFP VAT branch is reflected as the VAT registration number of the recipient (the VAT registration number of the implementing agency's main VAT registration may not be reflected on the tax invoice or other documentation).

The Public Finance Management Act¹⁷ procurement system

The implementing agency appointed by the foreign donor is in many instances an entity or institution within the public sector subject to the provisions of the Public Finance Management Act (PFMA). The purpose of the PFMA is to ensure transparency and control in all spheres of government's expenditure by setting operational procedures for, amongst others, procurement of goods or services by the implementing agency. For this purpose, National Treasury created and implemented certain requirements regarding procurement under the PFMA (the PFMA procurement system) that must be used by any public interest entity for the acquisition of goods or services.

In the event that the implementing agency is subject to the PFMA, any acquisitions for the purpose of the FDFP must also be done *via* the PFMA procurement system. In this regard, the implementing agency, in the capacity of the main VAT registration, acts as agent on behalf of the FDFP VAT branch in the PFMA procurement system in acquiring the goods or services on behalf of the FDFP VAT branch. For governance purposes, the order placed by the implementing agency on the PFMA procurement system on behalf of the FDFP VAT branch must somewhere reflect the project name as well as the FDFP VAT enterprise registration's VAT registration number. The tax invoice issued by the supplier may however contain the details of the implementing agency's main VAT registration (including the implementing agency's main VAT registration number) and not that of the FDFP VAT branch.¹⁸

¹⁵ Section 16(2)(a).

¹⁶ Note that in the case of "second-hand goods", the amount of input tax that is deductible is the tax fraction (that is, 15/115) of the payment made towards the purchase price.

¹⁷ 1 of 1999.

¹⁸ Refer to section 54(2).

The VAT Act requires an agent, being the implementing agency in the capacity of its main VAT enterprise, to maintain sufficient records to ensure that the name, VAT registration number and other relevant details of the principal, being the FDFP VAT branch, are readily available. The implementing agency must also ensure that each of the FDFP VAT branches receive a statement containing the following information regarding each supply made to the implementing agency in its main VAT registration's capacity as agent of the relevant FDFP VAT branch:

- Full and proper description of the goods or services
- The quantity or volume supplied
- The value of the supply, the VAT levied on the supply as well as the consideration for the supply

This statement must be provided to each FDFP VAT branch within 21 days of the month following the month in which the supply was made to the implementing agency in its main VAT registration's capacity as agent of the FDFP VAT branch.

The expenditure remains that of the FDFP VAT branch. It is therefore only the FDFP VAT branch that may deduct the VAT incurred on the goods or services acquired as input tax.

See the *VAT 404 – Guide for Vendors*, Interpretation Note 92 “Documentary Proof Prescribed by the Commissioner”, and BGR 36 “Circumstances Prescribed by the Commissioner for the Application of Section 16(2)(g)” for more details.

8.3 How is a deduction made?

Input tax and other deductions are declared on the VAT return for the particular tax period.

The deductions are set-off against the output tax liability on the VAT return. The output tax implications for foreign donor funding to a FDFP VAT branch is generally zero-rated (see 7.1). The difference between these two amounts can either give rise to a refund, or a liability for that tax period. If the deductions exceed the total output tax liability on the VAT return (and any other amounts that you may owe SARS for past tax periods or other taxes), or if there is no output tax for that particular tax period, the excess will be refunded.

Make sure that SARS has the correct banking details so that any refunds due can be paid safely and conveniently into the account without any unnecessary delays.

8.4 Period in which a deduction should be made

A deduction is only allowed in the tax period that the relevant prescribed or acceptable documentary proof is obtained. Further, to avoid forfeiting the claim, ensure that the deduction is made in time. A vendor generally has five years to make a valid input tax deduction.¹⁹ A deduction that was not permitted in accordance with the practice generally prevailing, is limited to six months before the tax period in which the deduction is made.²⁰

See the *VAT 404 – Guide for Vendors* for more information.

¹⁹ Paragraph (i) of the proviso to section 16(3).

²⁰ Paragraph (ii) of the proviso to section 16(3).

PART IV – DOCUMENTATION AND RECORD-KEEPING

The legislative amendments effective 1 April 2020 do not affect the requirement for an FDFP VAT branch to issue tax invoices, credit or debit notes and retain such documentation under the VAT Act and the TA Act. The vendor for VAT purposes making and receiving the supply of goods or services in the course of the project remains the FDFP VAT branch. Therefore, the FDFP VAT branch is required to issue tax invoices, credit and debit notes in accordance with the relevant VAT provisions.

9. Tax invoices

9.1 Introduction

The issuing of a tax invoice is an obligation on every vendor that makes taxable supplies in the course or furtherance of their enterprise and it is an integral part of the audit trail of a vendor and its activities. Failure to issue tax invoices is therefore a contravention of the VAT Act and vendors will be guilty of an offence.²¹ The TA Act requires all vendors to maintain records in their original form, for example, tax invoices, and for those records to be kept at a safe location.

9.2 What are the requirements for tax invoices?

The FDFP VAT branch is required to issue a full tax invoice to the foreign donor in respect of the deemed supplies made by it within 21 days of the supply having been made where the consideration for the deemed supply exceeds R50. Generally, a tax invoice must be in South African currency, except for a zero-rated supply (for example, the deemed supply made by the FDFP VAT branch to the foreign donor).²²

The following information must be reflected on a full tax invoice issued by the FDFP VAT branch for it to be considered valid:²³

- Any one of the following phrases or words indicating it to be a tax invoice:
 - “tax invoice”;
 - “invoice”; or
 - “VAT invoice”.
- Name, address and VAT registration number of the FDFP VAT branch.²⁴

As the foreign donor or public authority has legally entered into a contract with the implementing agency, as a legal person, and the FDFP VAT branch falls under the legal persona of the implementing agency, the foreign donor or public authority expects all correspondence relating to the project to be with the implementing agency itself and not the FDFP VAT branch, meaning the project, itself. For this reason, it is common for the tax invoice to be issued reflecting the name and business address of the implementing agency and the details registered for its main VAT registration. This may be acceptable, as long as the VAT registered name of the FDFP VAT branch is also reflected on the face of the tax invoice, clearly indicated as such. It must, however, be highlighted that only the VAT

²¹ Section 234 of the TA Act.

²² See BGR 11 “Use of an Exchange Rate” for more information.

²³ Section 20(4).

²⁴ See BGR 21 “Address to be Reflected on a Tax Invoice, Credit and Debit Note”.

registration number of the FDFP VAT branch and not that of the implementing agency's main VAT registration may be reflected on the tax invoice.

- Name, address and VAT registration number of the recipient.

The foreign donor is unlikely to be registered as a VAT vendor in South Africa and will therefore not be in possession of a VAT registration number to be reflected on the tax invoice.

- Serial number and date of issue.

The FDFP VAT branch is deemed to be separate from the implementing agency's main VAT registration. The implementing agency must therefore ensure that its main VAT registration as well as each FDFP VAT branch managed by it has its own set of tax invoices with a sequential serialised number.

- Full and proper description of the services.

The number assigned to the FDFP, as indicated on the approval issued by National Treasury, must be reflected in the description of the service deemed to be supplied to the foreign donor.

- Quantity or volume of services supplied.

- Price and VAT levied, in accordance with any one of the three pre-approved methods as set out in the table below:

Method 1		Method 2		Method 3	
All individual amounts reflected.		Total consideration only and the VAT rate charged.		Total consideration and the VAT charged.	
Price (excl. VAT)	R500	The total consideration R575		The total consideration R575	
VAT charged	<u>R 75</u>	VAT included @ 15%		VAT included R 75	
Total including VAT	<u>R575</u>				

10. Record-keeping

The VAT Act prescribes records and documents that must be retained in addition to the records required under the TA Act.²⁵ This includes a record of all goods and services supplied by or to the vendor, the rate of tax applicable and all invoices, tax invoices, credit notes, bank statements, and details about any apportionment method used.

The VAT Act includes specific requirements on the issuing of tax invoices, debit and credit notes, and the TA Act prescribes the storage of these documents. In this regard it is very important for the implementing agency to keep the records of the implementing agency's main VAT registration and that of each FDFP VAT branch administered by it, separate. This includes separate accounting records, as well as the record-keeping of any documentary proof as required under the VAT Act and the TA Act. The reason for this is, amongst other, to limit the risk to SARS of input tax being incorrectly and/or unduly deducted.

²⁵ Section 55 of the VAT Act and Part A of Chapter 4 of the TA Act.

It is the implementing agency's responsibility to ensure that the input tax attributable to the project is deducted in the relevant FDFP VAT branch only (meaning, there may be no "double deduction" of input tax between more than one VAT registration). The implementing agency must therefore have sufficient processes in place to prevent the deduction of input tax in the incorrect VAT registered entity. In this regard, the implementing agency bears the risk, both financial and otherwise, should it be found that the VAT declared and deducted in the various VAT returns were not in accordance with VAT legislation. The implementing agency, being the main VAT registration, will be responsible for any interest and penalties arising from non-compliance.

The period for which the records must be retained is five years from the date a return has been submitted for a tax period. See the *VAT 404 – Guide for Vendors* for more guidance.

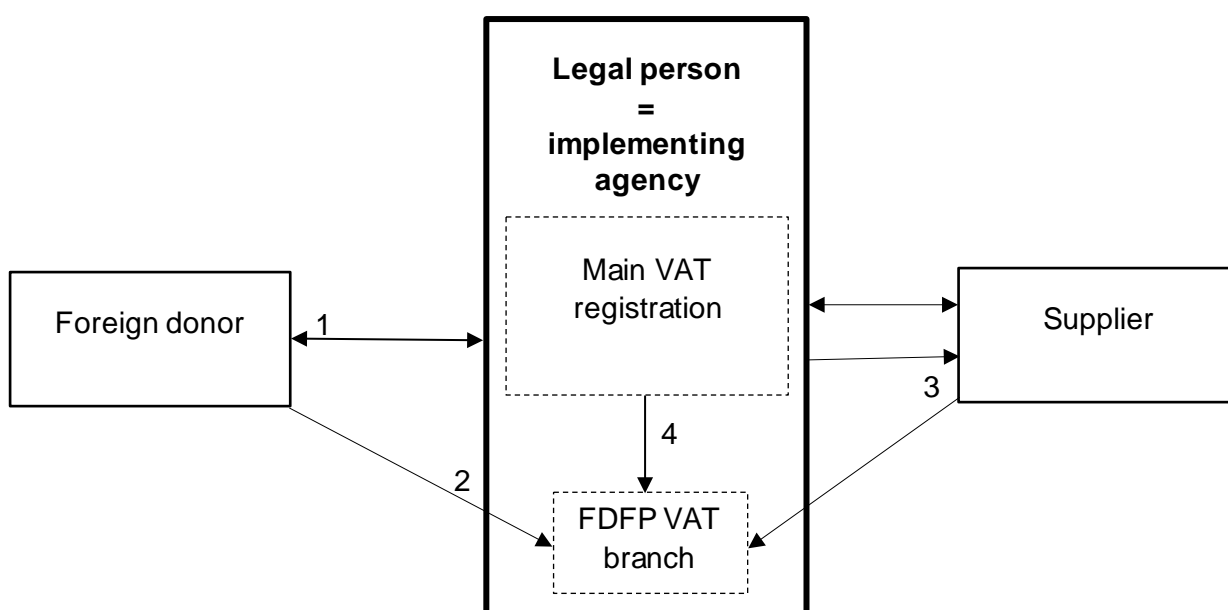
PART V – COMPREHENSIVE EXAMPLES

It is important to distinguish and identify the activities of operating, managing, administering or implementing an FDFP as the special VAT rules governing FDFPs are ONLY available to the said activities as reflected in the FDFP VAT branch. The VAT consequences of the implementing agency's main VAT registration as well as any supplies made by vendors to the FDFP VAT branch are subject to general VAT principles.

The structures set out below merely serve as guidance on how to identify the FDFP and the transactions flowing from or to it from a VAT perspective and are not intended to be exhaustive.

Structure 1: Basic foreign donor funded project structure

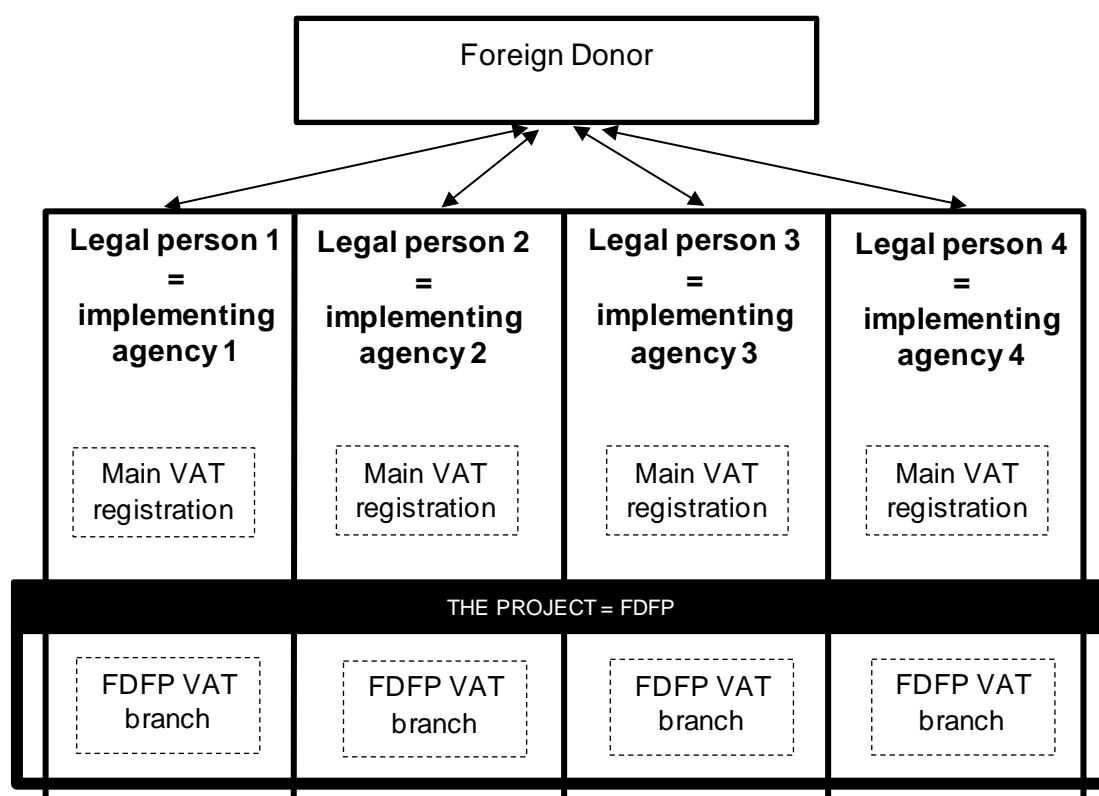
A typical (simple) structure of an FDFP and its implementing agency can be set out as follows:



- 1 The Foreign donor enters into a contract with the legal person, a registered vendor, to operate, implement, administer and manage a qualifying FDFP. The legal person is therefore the implementing agency of the FDFP and is required to register its activities in relation to the FDFP as a separate branch, being the FDFP VAT branch.
- 2 The FDFP VAT branch makes a deemed supply to the Foreign donor to the extent of the funding paid by the Foreign donor, albeit that such funding is paid into the bank account of the implementing agency. The FDFP VAT branch is required to –
 - a. declare in its VAT return the value of the deemed supply made to the Foreign donor as well as the VAT levied on such deemed supply at the zero rate; and
 - b. issue a tax invoice to the Foreign donor in respect of the deemed supply, reflecting all the relevant information as discussed in 9.

- 3 The implementing agency enters into a contract with and makes payment to the supplier, which in turn supplies goods or services (used by the implementing agency in operating, implementing, administering and managing the FDFP), to the FDFP VAT branch. The FDFP VAT branch is entitled to deduct the VAT incurred on the goods or services acquired as input tax in its VAT return.
- 4 The implementing agency, as part of its normal enterprise activities housed in the main VAT registration, supplies goods or services to the FDFP VAT branch. The main VAT registration must declare the relevant output tax in its VAT return whilst the FDFP VAT branch is entitled to deduct the VAT incurred as input tax in the relevant VAT return.

Structure 2: Multiple implementing agencies for one project



A foreign donor may enter into agreements with more than one legal person; each to operate, implement, administer and manage specific portions of one project. This project qualifies as an “FDFP” as defined. Each of the legal persons entering into an agreement with the foreign donor qualifies as an implementing agency and is therefore required to register their respective activities in relation to the FDFP as separate branches.

Each implementing agency is required to record and account the relevant transactions of the FDFP VAT branch as illustrated in structure 1.

Each FDFP VAT branch separately registered by each of the implementing agencies only makes deemed supplies to the foreign donor to the extent of the funding received by the specific implementing agency in relation to the portion of the project for which that implementing agency was contracted (is responsible).