Value-Added Tax apportionment methodology applied in the higher education sector of South Africa

Is the apportionment method currently applied in the higher education sector effective and appropriate in a South African context?

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Abstract

This dissertation focusses on the value-added tax apportionment methodology applied in the higher education sector of South Africa. The current apportionment method applied by universities is the varied input-based method. The research question that is posed, is whether the varied input-based method is effective and appropriate in the higher education sector in a South African context and whether or not there are other solutions which could apply to alleviate the burden that apportionment has placed on the universities.

In addressing the research question the dissertation specifically discusses the principles of apportionment, turnover-based method, input-based method and varied input-based method. Furthermore, the dynamics of the higher education sector is discussed in detail with specific focus on the income streams and expense types of universities and how this influences the application of apportionment methods. Lastly, other solutions are considered such as a reduced Value-Added Tax rate for the supply of educational services and the zero-rating of the supply of educational services.

It is concluded that the varied input-based method is definitely not the long term solution as the difficulty in its application and the financial burden makes it impracticable to use.

Also, it is concluded that a possible solution is to zero-rate the supply of educational services by universities in terms of section 11 of the Value-Added Tax Act No. 89 of 1991. This would not only alleviate the burden of apportionment, but also result in universities being allowed to claim all the VAT it incurs (except for input tax denied in terms of section 17(2) of the Value-Added Tax Act No. 89 of 1991) and result in a net gain for the universities.

Whatever is decided, the current investigation of apportionment methodology applied in the higher education sector of South Africa needs to be concluded as soon as possible and a clear practical and sustainable approach needs to be agreed upon, as it is in the best interest of all of the parties involved as well as South Africa and the education of its people as a whole.
iii List of abbreviations, Glossary of terms

The following abbreviations and terms will be used throughout this dissertation and are abbreviated or defined as follow:

“adjustment” – the amount calculated as the difference between the ratio applied during the year (i.e. the previous year’s ratio) and the ratio calculated at year end, being either due to or refundable by the South African Revenue Service

“approval from SARS” – refers to approval obtained from the Commissioner of the South African Revenue Service

Binding General Ruling – BGR

“code” or “coding” – to classify income streams or expenses incurred in terms of the Value-Added Tax Act No. 89 of 1991 according to an apportionment method

Department of Trade and Industry – DTI

“formula” – the formula to be applied in terms of a method of apportionment

Income Tax Act No. 58 of 1962 – IT Act

“method” – apportionment method

“mixed expenses” or “mixed purposes” – where goods or services are imported or purchased locally for taxable and other non-taxable purposes (South African Revenue Service – Legal and Policy Division [SARS – LAPD], 2015:45)

“non-taxable purpose” – This is where goods or services are acquired for purposes of consumption, use or supply in the course of making exempt supplies or other non-taxable supplies, or for private, non-business purposes (Juta’s, 2015)

National Research Foundation – NRF

“percentage” or “ratio” – this refers to the percentage that is obtained by applying an apportionment method

“ruling” – apportionment ruling

South African Revenue Service – SARS

Tax Administration Act No. 28 of 2011 – TAA

Universities South Africa – US

Value-Added Tax – VAT

Value-Added Tax Act No. 89 of 1991 – VAT Act


Value-Added Tax Class Ruling – VCR

“vendor” – as defined in section 1 of the Value-Added Tax Act No. 89 of 1991

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1 Juta’s - RS 8, 2012 JUTA’S VALUE-ADDED TAX 17-5
Any reference to “section” is a reference to a section of the VAT Act unless stated otherwise.
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1. Introduction

1.1. Background

The concept of apportionment, although not new to income tax, is clearly intended in section 17(1) of the Value-Added Tax Act No. 89 of 1991 (“VAT Act”). (Value Added Tax Act, No. 89 of 1991, 1991:s17) The VAT 404 guide² to the VAT Act summarises section 17(1) as follows:

“Generally, the full amount of VAT incurred on goods and services acquired or imported by a vendor for the purposes of making taxable supplies may be deducted as input tax. However, where goods or services are imported or purchased locally for taxable and other non-taxable purposes (mixed purposes) only a portion of the VAT incurred may be deducted. Therefore, when goods and services are not acquired exclusively for taxable supplies, you will be required to determine the part that relates to taxable supplies and the VAT incurred only qualifies as input tax to that extent.”³
(SARS – LAPD, 2015:45)

Although the VAT Act is relatively new in the South African tax law environment, having commenced on 30 September 1991, the concept of apportionment, which can be found in its most simplest of forms in section 17(1) in the said Act, was introduced into South African tax legislation by the Additional Taxation Act No. 36 of 1904⁴. (Additional Taxation Act, No. 26 of 1904, 1904:s60) The first South African income tax act incorporated this concept into its first version, the Income Tax Act No. 28 of 1914⁵. (Income Tax Act, No. 28 of 1914, 1914:s10)

A later version, the Income Tax Act No. 41 of 1917 section 14, provided that “when the business of any person, other than a person carrying on the business of insurance, extended to any country outside the Union, the taxable income of such person should be a sum which should bear the same proportion to his whole net profit as his assets in the Union bore to his total assets”. Needless to say the South African courts have had to interpret the concept of apportionment in its various forms in countless cases. (Income Tax Act, No 41 of 1917, 1917:s14)

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² It is important to note that Guides are binding on SARS but not on the taxpayer.
⁴ See section 60(2) Additional Taxation Act No. 36 of 1904
⁵ See section 10(2) Income Tax Act No. 28 of 1914
Even though the bulk of these cases, relating to apportionment, dealt with apportionment from an income tax perspective, it is important to revisit these judgments before any discussion relating to apportionment from a VAT perspective can commence, these judgements lay down the foundation of the concept of apportionment in a South African tax law context and also considers various facets of apportionment, such as how and when to apply apportionment, as well as the considerations of the applicability of apportionment in various situations. It is these considerations and arguments that have influenced the way in which apportionment is applied in a VAT context. The method applied in various sectors or by a specific vendor within a sector might differ, but the principles in determining a fair and reasonable, as well as a consistent method, are still the same. These principles have been laid down in the South African tax courts.

In the next chapter of this dissertation, the principles, the generally accepted method of apportionment and the necessity of other methods are discussed. In light of the principles and the generally accepted method, the higher education sector has reached a point where it needs to reconsider the effectiveness of the currently applied method.

The content chapters of this dissertation will discuss the method currently applied in the higher education sector and determine whether or not it is effective and appropriate in a South African context?

1.2. Research question

The only method allowed by SARS for the apportionment of VAT incurred without having to apply for its use, is the turnover-based method. The turnover-based method does not provide a fair and reasonable result when applied to universities (discussed in detail later in this dissertation). Therefore, the Universities South Africa (“US”) applied on behalf of its members to SARS for the approval of a different method.

As a result of this ruling application SARS issued a VAT Class Ruling (“VCR”) on 1 August 2012 to all universities that are members of US. The ruling only applied for a period of 9 months, from 1 April 2012 until 31 December 2012. The ruling has been extended multiple

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6 On 22 July 2015 Higher Education South Africa (HESA) became US. US was formed on 9 May 2005, as the successor to the two statutory representative organisations for universities and universities of technology (former technikons). These organisations were, respectively, the South African Universities Vice-Chancellors Association (SAUVCA) and the Committee of Technikon Principals (CTP).
times, the latest one being until 31 December 2015 which effectively means until the 2015 financial year of the universities listed in the ruling, as its year ends are all December. The VCR allows for the application of the varied input-based method, with specific reference to the treatment of expenses incurred for research.

The fact that the initial ruling was issued for a relatively short period\(^7\) and then subsequently extended for another relatively short period is an indication of the current state of flux that the sector finds itself in with regards to which method, if any, to apply.

Although the current method might provide for a more fair and reasonable apportionment than the turnover-based method (refer to chapter 2), the quantitative and qualitative factors which play a role in calculating the apportionment percentage needs to be weighed up against the application of this method.

The research question therefore is whether the varied input-based method is effective and appropriate in the higher education sector in a South African context and whether or not there are other solutions which could apply to alleviate the burden that apportionment has placed on the universities. This dissertation discusses the current concerns and considerations that are part of applying the varied input-based method in the context of a university and the objective is to determine whether this method is the most effective method and whether or not there are other solutions which could apply to alleviate the burden that apportionment has placed on the universities.

1.3. Research method

The research method used to compile this dissertation is mainly doctrinal in nature and is a combination of analysing the ruling which applies to the higher education sector and comparing this to other methods available. The latest sector developments and possible legislative amendments are discussed and how this might impact on the applicable method in future to enable a conclusion on whether or not the current method is effective and appropriate in a South African context.

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\(^7\) Some rulings which relate to the method of apportionment are issued for longer periods, such as in the life insurance- and welfare organisation industries, where there are current rulings that are issued for periods of 7 and 3 years respectively.
Specifically, the rulings that will be analysed will be the rulings issued by SARS to the specific class (i.e. sector) or entities within the sector, as well as the application letter to obtain these rulings. The reason the application letter needs to be considered is the fact that it often provides insight into a sector, explaining the difficulty a sector might be experiencing in applying either the turnover-based method or another previously approved method. Rulings issued by SARS generally discuss the method which it approves and does not provide detail regarding the other methods which it does not approve. The application letters often discuss the various methods available and whether or not it could provide a percentage which reflects the principles of apportionment (as set out above) for a specific sector or vendor within a sector.

With regards to gaining an insight into the various sector developments and potential changes, discussions are held with sector experts in the field of VAT apportionment methodology. Furthermore, I will be consulting and reviewing case law and writings of experts in the field.

1.4. Limitations of scope

Although the field of VAT apportionment influences most sectors and / or individual vendors the scope of this dissertation is limited to the general prevailing method used in the higher education sector and the vendors listed in the VCRs who must apply it.

There might be instances where the majority of vendors in a specific sector might apply a specific method, but certain vendors within that sector apply a different method than the norm, due to its own unique business structures. In these instances, note that this dissertation only discusses the general method prevailing within a sector (i.e. the method the majority of vendors apply within a specific sector).

1.5. Structure

This dissertation will set out to determine whether or not the current apportionment method applied within the higher education sector is effective and appropriate in a South African context and whether or not there are other possible solutions to the current difficulties that are experience in this regard. The content chapters are set out as follow:
Chapter 2 (first content chapter) – This chapter will discuss the principles of apportionment that have been laid down in the South African tax courts. It will also discuss the turnover-based method of apportionment.

Chapter 3 (second content chapter) – This chapter will discuss the input-based method of apportionment. Furthermore, this chapter will discuss the current apportionment methodology in the higher education sector of South Africa.

Chapter 4 (third content chapter) – This chapter will discuss the dynamics of the higher education sector of South Africa. It will specifically focus on the income streams of universities, as well the expense types and its related VAT treatment and coding.

Chapter 5 (fourth content chapter) – This chapter will discuss possible other solutions to the difficulties currently experienced with applying apportionment in the higher education sector of South Africa. This chapter will conclude with the latest sector developments.

Chapter 6 – This chapter will reach a conclusion based on the research question posed.
2. Apportionment methodology

2.1. Introduction

This chapter will discuss the principles of apportionment in a South African context, specifically looking at the origin of the principles as well as the application of the principles in apportionment methodology. The chapter will then discuss the concept of apportionment in its broad sense and then explain the generally accepted method of apportionment, i.e. the turnover-based method.

This chapter will conclude by discussing the necessity of other apportionment methods.

2.2. Principles of apportionment laid down in South African tax courts

As there is no set law governing apportionment methodology, methods or when apportionment might be applicable, certain principles of apportionment have come to the fore in our tax courts over the years in addressing this void. It is these principles that are applied in determining what the most appropriate VAT method is in a specific sector, vendor’s business or a specific situation within a vendor’s business.

2.1.1. Principle of ‘direct attribution’

One has to go no further than the *Overseas Trust Corporation Ltd* case of 1926\(^8\) to find one of the first judgments which had to consider a core principle of apportionment, that of ‘direct attribution’. At the current time residents of South Africa were taxed on a source basis and foreign income earned was excluded from the tax net. The judge, Innes CJ, had to consider the fact that the company (which was registered and had its principal office in Cape Town, but was also registered in Windhoek and had within the Territory of South-West Africa a registered office at which an official was stationed to accept services) claimed that its business operations extended beyond the Union. Resultantly, that it was entitled to avail itself of the provisions of section 14 of Income Tax Act No. 41 of 1917 and apportion its profits between the Union and elsewhere on the basis of the assets situated respectively within and without the Union.

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\(^8\) Overseas Trust Corporation Ltd v Commissioner for Inland Revenue 1926 AD 444, 2 SATC 71
Judge Innes CJ found that the mere possession of shares and investments did not amount to carrying on a business; and the taxpayer would appear to have conducted no operations of any description in the Territory of South-West Africa. It was impossible, therefore, to hold that its business extended to that territory.

This discussion was continued in the Rhodesia Metals Ltd case of 1938 and judge Stratford CJ said that a company can carry on business in more places than one and in places where it has no residence. The question is thus, was the capital productively employed and what was instrumental in producing the profit (i.e. was it the capital or the brains)? It is this type of consideration (in the Rhodesia Metals Ltd case supra instance, the consideration specifically being where the place of business could be directly attributed to) that forms a fundamental part of any VAT apportionment calculation, that being the concept of ‘direct attribution’.

Before attempting to apportion an expense, the first step is to determine if the expense can be directly attributed. The principle can be found in section 17(1)(i) where the VAT Act states that “where the intended use of goods or services in the course of making taxable supplies is equal to not less than 95 per cent of the total intended use of such goods or services, the goods or services concerned may for the purposes of this Act be regarded as having been acquired wholly for the purpose of making taxable supplies”. (Value-Added Tax Act, No. 89 of 1991, 1991:s17) This implies that where expenses can be directly attributable (to at least 95%) to the making of taxable supplies, the VAT incurred on such expenses does not have to be apportioned and the VAT incurred on such expenses can be claimed in full.

The VAT 404 explains the concept of ‘direct attribution’ as follows: “‘Direct attribution’ means that you will be required to attribute the VAT expense according to the intended purpose for which the goods or services acquired will be used.

‘Direct attribution’ means that the expense is incurred either:

- wholly for making taxable supplies, in which case the VAT incurred can be deducted in full; or
- wholly for making exempt supplies or other non-taxable purposes, in which case no VAT incurred on the expense can be deducted as input tax.

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9 Liquidator, Rhodesia Metals Ltd v Commissioner of Taxes, Southern Rhodesia 1938 AD 282, 9 SATC 363
It is only when the expense cannot be directly attributed that the expense must be apportioned. Once it is clear that the expense must be apportioned, the next step is to calculate the proportion of VAT which may be deducted as input tax. This is referred to as the apportionment ratio and is expressed as a percentage. Although there may be a few exceptions, the most common expenses that need to be apportioned are the general overheads of the business. Other expenses are usually capable of being allocated wholly to either taxable or non-taxable purposes by applying the concept of ‘direct attribution’.

Where the acquisition of goods or services can be identified as being **exclusively or wholly** incurred for a particular purpose, the VAT incurred on those supplies can either be deducted in full (wholly for taxable supplies), or no VAT may be deducted as it does not qualify as input tax (wholly for exempt or other non-taxable purposes). In applying the concept of ‘direct attribution’, the manner in which expenses are incurred and the actual application of the goods or services in the business must be examined. Where a vendor makes only taxable supplies, this is a simple exercise in that the VAT incurred will usually be exclusively for taxable supplies, and the VAT incurred may be deducted as input tax in full. However, where a vendor makes both taxable and exempt supplies, the first step is to determine whether the expense is directly attributable to taxable, exempt or other non-taxable supplies.” (SARS – LAPD, 2015:45-46)

‘Direct attribution’ comes to the fore in two instances in a VAT apportionment methodology context, either in a case where it needs to be determined on which expenses the apportionment percentage will be applied or in a case where the VAT method is a variant of the input-based method. In the former case if an expense cannot be directly attributed to either taxable or non-taxable purposes, the expense is seen as a mixed expense and it needs to be apportioned, to determine which portion of the VAT incurred on the mixed expense will be recoverable. In the latter instance ‘direct attribution’ is necessary to determine whether an expense will be included in the formula or not. If the expense can be directly attributed to the making of a taxable supply it would be included in both the numerator and the denominator of the formula, alternatively if the expense is directly attributable to a non-taxable purpose, it would only be included in the denominator. However, if the expense is a mixed expense, it would not be included in the formula at all; instead the resultant percentage from the formula will be used to determine which portion of the VAT incurred on the mixed expense will be recoverable.
2.1.2. Principles of ‘consistency’ and ‘fair and reasonable’

In the Guardian Assurance Holdings SA Limited case of 1976\(^{10}\) the taxpayer decided to use a public offering of shares instead of a private offering as the taxpayer expected there to be an over application for the shares. The taxpayer’s plan was to invest the excess money received to earn interest for a short term of two to three weeks, i.e. until refunds were to be made of the excess application monies. By doing so they would receive in interest not only enough to cover the extra expenses which were involved with a public subscription, but also a very substantial profit.

The taxpayer reflected this sum in its return of income for the tax year ended 31 December 1968 together with a deduction of expenses claimed as revenue expenditure incurred in earning the interest. The amount of the deduction was determined by apportioning the aggregate flotation expenses. This was done by calculating the difference between the expenditure actually incurred and that which would have been incurred had the shares been offered by way of a private placing.

In the course of its judgment the Special Court expressed the views that the taxpayer had two dominant motives in incurring the total expenses, namely the raising of capital and the making of a profit by way of interest; that apportionment of the expenses between those two objectives was permissible in principle; and that section 23(g) of the IT Act\(^{11}\) (which precludes the deduction of monies ‘not wholly or exclusively laid out or expended for the purposes of trade’) did not debar the expenditure in issue from deduction.

The Special Court also argued that the acquisition of capital for business seems to me to be clearly “for the purposes of trade”. The court continued to look at Silke South African Income Tax 6 ed at 196 which had a further example of where apportionment is permissible: Where expenditure is incurred partly for the purpose of deriving income which is not of a capital

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\(^{10}\) Secretary for Inland Revenue v Guardian Assurance Holdings SA Limited 1976 AD, 38 SATC 111

\(^{11}\) Interesting to note that in the Income Tax Act No. 141 of 1992 the words “which are not wholly and exclusively” were deleted from section 23(g) of the said Act and replaced with the words “to the extent to which such moneys were not”, which is in clear support of the concept of apportionment, despite the judge in the Guardian Assurance Holdings SA Limited case already eluding to the fact the wording as it stood at that stage did not debar the expenses from deduction if it was incurred for mixed purposes. The Explanatory Memorandum to the said Amendment Act states that it has been a long-standing practice of Inland Revenue, which has in the past been accepted by the courts, to allow an apportionment of expenditure which is incurred partly for purposes of trade and partly for purposes other than trade. The Explanatory Memorandum explicitly states that this amendment to section 23(g) of the IT Act is intended to restore the practice of allowing for apportionment of such expenditure.
nature and partly for the purpose of acquiring a fixed capital asset for the business. In all these cases it is considered that the expenditure is, nevertheless, wholly or exclusively laid out for the purpose of trade and that an apportionment is permissible.

In the Appellate Division SARS’ contention was that the expenditure was not incurred only in the production of income - the self-same expenditure was incurred for the purpose of a capital nature and therefore falls outside section 11(a) of the IT Act. SARS did not contend that the expenditure was debarred as a deduction under section 23(g) of the said Act as they did in the Special Court. The crux of its contention was that expenditure cannot be deducted if it is “blemished” or “tainted” with any element of private purpose not linked with trade.

To this argument the judge, Muller JA, said that it would be anomalous and inconsistent totally to disallow trade expenditure under section 23(g) of the IT Act, because it is in part expended for private purposes and yet to allow a deduction under section 11(a) of the said Act, where expenditure is partly for income purposes and partly for capital purposes. The judge reiterated the principle of consistency by stating that “the expenditure which is of a capital nature is disallowed under section 11(a) of the IT Act and expenditure which is of a private nature is disallowed under section 23(g) of the said Act” and by asking “why should apportionment be permissible in the former case and not in the latter?”

‘Consistency’ is crucial to any method, as there are no hard and fast rules or laws governing the application of the various apportionment methods that have been approved by SARS and each apportionment ruling application is assessed on an individual basis, although SARS does take cognisance of prior rulings within a specific sector, as well as rulings of a similar nature before issuing a ruling to approve a specific method. The fact of the matter is clear, without set rules or laws governing methods as a whole, one is left with no other option but to apply the core principles in determining what is the most appropriate method in a specific situation. No doubt the presence of rules and laws to govern methods, would have resulted in the consistent methods and percentages, therefore, without this in place a core principle of determining the most appropriate method must be that of ‘consistency’.

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12 This point made by the judge is an important point to bear in mind when applying the principle of ‘consistency’. As items of a capital nature are not to be included in a formula as it might distort the percentage calculated year-on-year and render it inconsistent as explained. Note that this exclusion will only apply where the vendor concerned does not usually supply capital items on a regular basis as a normal part of the business (whether those supplies are made under instalment credit agreement or under an ordinary sale).
‘Consistency’ plays an important role in various aspects of apportionment methodology and methods. First of all, the method being applied needs to be applied consistently on a year-on-year basis. As per section 17(1) the ratio which may be applied by a vendor will be as determined by SARS in accordance with a ruling as contemplated in Chapter 7 of the Tax Administration Act (“TAA”) or section 41B. SARS has published Binding General Ruling\textsuperscript{13} (“BGR No. 16”), setting out the ratio allowed by SARS. “The only approved method which may be used to apportion VAT incurred for mixed purposes without specific prior written approval from SARS, is the turnover-based method. This method applies by default in the absence of a specific ruling obtained by the vendor to use another method as there is usually a fairly good correlation between the turnover of a business and the resources (or inputs) which are employed to produce that turnover. Where a specific ruling has been granted to the vendor, the vendor cannot go back to using the turnover-based method, where it is inappropriate, without requesting a further ruling.

Note, however, that in circumstances where the turnover-based method is inappropriate because it produces an absurd result, proves impossible to use, or does not yield a fair approximation of the extent of taxable application of the enterprise’s VAT-inclusive expenses, the vendor must approach SARS to obtain consensus on an alternative method which yields a more accurate result.”\textsuperscript{14} (SARS – LAPD, 2015:48)

\textsuperscript{13} In terms of section 41B of the VAT Act a “VAT class ruling” means a written statement issued by the Commissioner to a class of vendors or persons regarding the interpretation or application of the said Act. In terms of Chapter 7 of the TAA states in section 75 that a ‘binding general ruling’ means a written statement issued by a senior SARS official under section 89 regarding the interpretation of a tax Act or the application of a tax Act to the stated facts and circumstances. Section 41B(1) of the VAT Act links the two definitions by stating that the Commissioner may issue a VAT ruling and in applying the provisions of Chapter 7 of the Tax Administration Act, a VAT ruling must be dealt with as if it is a binding class ruling or a binding private ruling. Therefore, despite the promulgation of the TAA the purpose of a binding general ruling issued by SARS remains the same, i.e. as set out in section 76 of the TAA “the purpose of the ‘advance ruling’ system is to promote clarity, consistency and certainty regarding the interpretation and application of a tax Act by creating a framework for the issuance of ‘advance rulings’”. Section 82 of the TAA confirms that binding general rulings are binding on both SARS and the taxpayers.

\textsuperscript{14} It is important to note that even though no prior approval is necessary for the use of the turnover-based method, if the method produces an absurd result, proves impossible to use, or does not yield a fair approximation of the extent of taxable application of the enterprise’s VAT-inclusive expenses, a vendor is not allowed to use the method. This implies that without further approval from SARS to apply a different method, no input tax claim will be allowed on mixed expenses.
Therefore, a vendor needs to start off by determining whether the turnover-based method is appropriate in its specific situation. If this method is not appropriate a vendor needs to either develop its own method (and request permission from SARS to apply it), which provides a fair and reasonable reflection of its operations or consider other methods that have been approved by SARS in the past and could be applied to the vendor’s business. Whichever method a vendor chooses to apply for, and obtains subsequent approval of, is the method a vendor has to apply year-on-year, i.e. consistently, all else remaining constant.

Hence a vendor cannot apply for another method as a result of the turnover-based method not being appropriate in year 1, and then as a result of the turnover-based method yielding a higher percentage in year 2, choose to apply the turnover-based method in year 2 again. Only if the method results in a percentage which is not fair and reasonable or where the vendor undergoes a change to its business which results in the extent of the purpose of its taxable and non-taxable supplies being significantly different after that event, would the vendor be expected to approach SARS to confirm whether the current method is still appropriate or apply for an alternative method. A vendor therefore needs to be certain when it applies for an alternative method, as SARS wants to ensure a method is applied consistently and will not approve a change in method, without there being plausible reasons that the current method (that could either be the turnover-based method or a different method approved by SARS) is not producing a fair and reasonable result. In other words SARS will disallow a ruling application if the vendor is merely applying for alternative methods each year to achieve the highest percentage possible. ‘Consistency’ being the key principle a vendor needs to keep in mind in applying for an alternative method.

Secondly, the resultant percentage obtained by applying a method consistently, also needs to be consistent. This simply means that a method that results in a percentage fluctuating materially year-on-year will also lead to SARS not allowing such a method to be applied. Again there are no hard and fast rules or laws which assist in determining whether a percentage is consistent enough from SARS’ point of view. However, there are certain benchmarks which a vendor can look at to try and determine whether or not a method provides a consistent percentage, such as the sector norm. If a percentage is not in line with the rest of the sector in which that vendor operates and the vendor is applying the same method as other vendors in that sector, it could be an indication that the percentage is not consistent enough to be applied. Again this will not be so in all instances, if a vendor can substantiate the reason why its percentage would be different from the rest of the sector when applying the same method and the percentage is consistent year-on-year then SARS would most likely allow the use of the method.
Another benchmark could be the vendor itself. When applying for an alternative method a vendor has to explain and be able to show SARS that the method being applied for is fair and reasonable in its specific instance. To prove to SARS that the method is fair and reasonable the vendor needs to apply the method to its own data for the years leading up to the year in which the application is submitted. Therefore, when a vendor applies the method to itself, for say the last three years, the vendor would quickly be able to ascertain whether the method results in a consistent percentage or whether it fluctuates materially year-on-year.

The principle of 'consistency' is crucial to SARS in deciding whether or not to approve a method. If a method does not result in a consistent percentage or a method is not applied consistently, SARS is at risk of the vendor making fraudulent claims as a result of manipulation of the vendor's own data. If SARS does not enforce this principle when issuing rulings, vendors will have free reign to manipulate, change, adjust, and retrospectively apply whichever method or percentage they see fit, which will result in material losses to the fiscus. As a result of the complexity and difficulty of apportionment calculations, SARS cannot audit each and every calculation and corresponding claim or repayment on a yearly basis. SARS just does not have the resources to perform such a task and therefore it is crucial that when SARS approves the use of a method, that this principle has been considered. This will ensure that SARS has comfort, that during a year in which it does not audit a claim or repayment resulting from an apportionment calculation, the principle of consistency would have been present whilst applying an approved method.

It is also important to take from the judgment in the Guardian Assurance Holdings SA Limited case supra, that in SARS’ contention it did not cite any authority in support of its main submission that, where expenditure is incurred for a dual purpose - the one being the raising of capital and the other being the earning of income - and the expenditure cannot be dissected and allocated to the different objects, then no apportionment is permitted. The judge said that in the absence of any prohibition or direction in the IT Act itself, I can see no reason why, in principle, an apportionment should not be applied in the instant case. It is therefore important to note, that unless prohibited by law, if apportionment is necessary, i.e. in the case of a vendor incurring mixed expenses, a vendor is at liberty to either apply the turnover-based method or apply for an alternative method to apportion the mixed expenses incurred.
In the *Guardian Assurance Holdings SA Limited* case supra the expenditure was incurred for a dual purpose and it was physically impossible to dissect the various items of expenditure for allocation to the different objects. The judge said that despite that fact he could still not agree with SARS’ further contention that, for that reason, the expenditure as a whole must, for the purposes of the IT Act, be regarded as expenditure of a capital nature within the meaning of section 11(a) of the said Act. The judge said that in the instant case it is not disputed that expenditure was deliberately incurred and it seems that it would be contrary to the basic principles of the Act not to permit of an apportionment and to declare such expenditure to be non-deductible merely because it is inextricably tied up with the expenditure which in any event had to be incurred for the purpose of raising the required capital. This is also a very important point to keep in mind, that although on face value it might seem impossible to apportion an amount which has clearly been incurred for two purposes or result in two different outcomes (such as the making taxable and non-taxable supplies), it does not mean that there might not be some other method, specific to the scenario that could be used to apportion an amount.

On the method applied in the *Guardian Assurance Holdings SA Limited* case supra by the taxpayer the judge said that it is sufficient to say that he cannot express agreement with the view that any apportionment in this type of situation must necessarily be arbitrary or that the apportionment suggested by the taxpayer in the instant case is an arbitrary apportionment. Prima facie the method applied by the taxpayer appears to him to be sensible and clear, but even if he was to be wrong in holding that view, there could be other possible methods by which a logical and fair apportionment could be made.

This aspect of the judgment addresses the final principle of apportionment, that of ‘fair and reasonableness’. It is clear from what has already been written, that SARS will not allow any arbitrary method to be applied. A vendor needs to be able to justify by way of explanation and calculation that a specific method is applicable to its business. If a mixed expense cannot be apportioned, then that will be to the loss of the vendor, and therefore the onus rests on the vendor to justify an alternative method in cases where the turnover-based method does not render a fair and reasonable result.

The judge in the *Guardian Assurance Holdings SA Limited* case supra said that he cannot agree with SARS’ alternative contention that the object of raising capital should, on the facts of the case, be regarded as the ‘dominant purpose’ of the whole operation, before the expenditure was incurred, the taxpayer decided to adopt a method by which it could pursue two objectives, namely, to raise the required capital, and to earn an income.
The judge held that inasmuch as expenditure in excess of that required to raise the capital by a private placing had been incurred with the express object of producing income, it would be contrary to the basic principles of the IT Act not to permit an apportionment.

This further goes to show that the onus rests on the vendor to prove that an expense is incurred for a dual purpose and therefore classified as a mixed expense of which a portion of the VAT incurred will be claimed. However, SARS cannot use the dominant purpose argument in order to refute such a classification. If there are clearly two purposes (i.e. taxable and non-taxable) for the expense being incurred, then the expense shall be classified as a mixed expense, irrespective of the split between its taxable and non-taxable purpose. A portion of the VAT incurred on such an expense shall be repayable by SARS if a valid method to apportion the said expense is approved by SARS or the turnover-based method of apportionment is applied.

In summary the judge in the Guardian Assurance Holdings SA Limited case supra held that in premise a method need not necessarily be arbitrary; but that as the contention that only an arbitrary method is possible had not been raised in the Special Court, it sufficed to say that prima facie the method advanced by the taxpayer was sensible and clear and that, in any event, other methods of achieving a logical and fair apportionment may exist.

“In deciding which method is appropriate, the vendor must apply a common-sense approach which would be applied by a reasonable person. The method must therefore achieve a ‘fair and reasonable’ result which is a proper reflection of the manner in which the vendor’s resources (business inputs) are applied for making taxable and non-taxable supplies respectively.

Although the term ‘fair and reasonable’ will usually be perceived as a subjective concept, vendors applying the turnover-based method should try to be objective and consider that the result must be perceived as ‘fair and reasonable’ from SARS’s perspective as well. The result must also be capable of being justified as appropriate in the vendor’s circumstances. For example, where a company applies a method and it undergoes a major restructuring, or the nature of the business changes so that the extent of taxable and non-taxable supplies are significantly different after that event, the vendor would be expected to approach SARS to confirm whether the current method is still appropriate. Alternatively, if it is clear from the outset that the method will not yield a ‘fair and reasonable’ result after the changes, a ruling should be
obtained to apply another method which results in more ‘fair and reasonable’ proportion of VAT being deducted as input tax in the year that the changes occur, and in any subsequent years.

The apportionment percentage should not be excessive or extreme so that either a 0% or 100% result is achieved. If an extreme result is achieved, it is usually an indication that either the formula is inappropriate, or it is not being applied correctly. As an example to illustrate the point, it would generally be unreasonable to conclude that a vendor whose principal business is the financing of motor vehicle purchases under instalment credit agreements will achieve a de minimis apportionment percentage of 95% or more. Further, the vendor would have some difficulty in explaining why the method is ‘fair and reasonable’ where the norm for vendors in that sector ranges, for example, between 50% and 60%. Unless the vendor in that case can explain why its business is so significantly different from the sector norm that its position can be justified, SARS would consider applying a method which is used in that sector. Alternatively, SARS would consider another method which is more in line with the sector norm that is ‘fair and reasonable’ in the circumstances.”

There might be instances where there are multiple methods which provide a ‘fair and reasonable’ result, i.e. the vendor is able to explain that these methods adhere to all of the principles discussed above and SARS is willing to allow any of these methods. In such a case the trite principle comes to the fore, which allows a taxpayer to order his affairs in a manner which is most tax effective as long as it is in accordance with the law.

2.2. The concept of apportionment in the VAT Act

Bearing the aforementioned principles in mind, the first version of the South African VAT Act introduced the concept of apportionment in section 17. As it currently still stands in section

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15 Where it is found that a vendor has applied the turnover-based method without considering whether the method is appropriate or whether it yields an unfair or unreasonable result, SARS reserves the right to recover the incorrect input tax claim and apply another method which is more appropriate. Where the use of the turnover-based method has resulted in a vendor deducting an unreasonable amount of VAT as input tax, the vendor will be liable to pay back the VAT that was incorrectly deducted, plus any penalty and interest thereon.

16 Juta’s - RS 9, 2013 JUTA’S VALUE-ADDED TAX 17-10

17 Inland Revenue Commissioners v The Duke of Westminster 1936 AC, 1 at 19
The concept of apportionment is seemingly straightforward in a VAT context. The subsection lays down the concept of apportionment in a VAT context by stating that where goods or services are acquired or imported by a vendor for consumption, use or supply in the course of making taxable supplies and for a non-taxable purpose, the extent to which any tax which has become payable is input tax\textsuperscript{19} which may be deducted under section 16(3), shall be an amount which bears to the full amount of such tax or amount, the same ratio as the intended use\textsuperscript{20} of such goods or services in the course of making taxable supplies bears to the total intended use of such goods or services. (Value-Added Tax Act, No. 89 of 1991, 1991:s17)

Therefore, the fact that a vendor makes taxable and non-taxable supplies and applies an apportionment percentage (calculated in accordance with this subsection) to determine his deductible input tax, does not mean that the apportionment percentage must automatically be applied to all VAT incurred by the vendor. “If a specific expense is incurred solely for taxable purposes, the full amount of VAT qualifies as input tax, while no input tax may be claimed where goods or services are acquired wholly for non-taxable purposes, i.e. the principle of direct attribution. Section 17(1) is thus only applicable to VAT incurred for mixed use purposes. If the actual use of the goods or services subsequently differs from the intended use, an adjustment must be made if the change in use falls within the ambit of section 18.”

The following formula can be used instead of the ratio:

\[
\frac{\text{input tax}}{\text{full VAT or notional VAT}} = \frac{\text{intended taxable use}}{\text{total intended use}}
\]

or

\[
\text{input tax} = \frac{\text{intended taxable use}}{\text{total intended use}} \times \text{full VAT or notional VAT}
\]

\textsuperscript{21} (Juta's, 2012)

\textsuperscript{18} Appendix A

\textsuperscript{19} Appendix A

\textsuperscript{20} The intended use of goods or services is the purpose for which the goods or services will be consumed, used or supplied by the vendor. A vendor must, at the time of acquisition of the goods or services, determine the intended use thereof. The apportionment percentage calculated must be applied to any goods or services acquired for mixed use purposes. This includes capital goods, consumables and trading stock.

\textsuperscript{21} Juta's - RS 8, 2012  JUTA'S VALUE-ADDED TAX  17-4B
Section 17 also makes reference to the fact that the ratio (i.e. method) is determined by SARS in accordance with a ruling as contemplated in Chapter 7 of the TAA or section 41B. (Value-Added Tax Act, No. 89 of 1991, 1991:s17, 1991:s41) (Tax Administration Act, No. 28 of 2011, 2011:chap7) Therefore, it is clear that the VAT Act itself does not provide any guidance on how to apportion an input tax claim on mixed expenses, except for stating that it needs to be in a ratio which represents the intended use of the goods or services in the course of making taxable supplies to the total intended use of such goods or services. The VAT 404 is *inter alia* published by SARS to aid in filling this void and guiding vendors on how to apportion its mixed expenses as well as discussing the method which it will allow without a vendor having to apply for a ruling approving the use of the method (i.e. turnover-based method). Extracts of the VAT 404 are discussed in great detail above as well as where the guide obtains the principles it lays down in the context of apportionment.

“Prior to 8 August 2007, section 17(1) provided that the deductible input tax had to be calculated in accordance with a general written ruling of SARS or a written ruling given by SARS to a vendor. The reference to sections 41A and 41B was inserted on that date, with effect from 1 January 2007, to allow SARS to determine the apportionment ratio by issuing rulings under these sections. The reference to Chapter 7 of the TAA (which deals with advance rulings) replaced the previous reference to section 41A (which dealt with advance tax rulings), with effect from 1 October 2012.

When VAT was introduced SARS prescribed two standard methods, input-based and turnover-based. The vendor could choose, without any prior approval from SARS, the method which provided the most favourable input tax percentage to calculate his proportion of taxable use or consumption of goods or services. The method selected had to be applied consistently to all goods and services which are partially attributed to taxable and non-taxable purposes.

However, with effect from the November 2000 tax period the input-based method is no longer a standard method. As from that tax period only the turnover-based method may be used without prior approval (but only if it does not give an unfair result). A vendor may now apply the input-based apportionment method only with the express prior approval of SARS.

If every vendor were allowed to determine the ratio which the intended taxable use of various goods or services bears to the total intended use thereof, using his own
apportionment basis, it would have created administrative problems to vendors and have resulted in inequities between vendors. SARS has therefore prescribed that, with effect from the November 2000 tax period, vendors must apply the turnover-based method in determining the percentage of intended taxable use. (Prior to this date vendors were allowed to apply either the turnover-based method or the input-based method.) A vendor may in certain circumstances apply to use a special method.

The percentage calculated in accordance with the apportionment method prescribed by SARS is the vendor's average percentage of intended taxable use. That percentage is applied to the amount of VAT or notional VAT incurred on any goods or services acquired for taxable and non-taxable purposes, whether the goods or services are of a capital nature or are acquired wholly or partly for purposes of entertainment. The vendor may therefore not determine the intended taxable use of each individual item of goods or services acquired by him by way of direct attribution.”22 (Juta’s, 2012)

Subsection 17(1) continues by providing some proviso’s to the concept of apportionment of which the first proviso states that where the intended use of goods or services in the course of making taxable supplies is equal to not less than 95\textsuperscript{23} percent of the total intended use of such goods or services, the goods or services concerned may for the purposes of this Act be regarded as having been acquired wholly for the purpose of making taxable supplies. The reason this proviso is deemed necessary is simply to alleviate the administrative (from a quantitative and qualitative perspective) burden of having to calculate a percentage each year where there is an insignificant non-taxable purpose. If a vendor consumes, uses or supplies goods or services for a non-taxable purpose which makes up more than 5% of its business then SARS deems it a material portion of the vendor’s business and the vendor then has to calculate a percentage and only claim input tax to the extent of that percentage on mixed expenses incurred. (Value-Added Tax Act, No. 89 of 1991, 1991:s17)

The second proviso to this subsection refers to where goods or services are deemed by section 9(3)(b) to be successively supplied and is not of importance in the context of this dissertation. “Section 9(3)(b) refers to goods supplied progressively or periodically under an agreement providing for the payment of instalments or for

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22 Juta’s - RS 8, 2012  JUTA'S VALUE-ADDED TAX  17-6

23 Prior to 24 September 1999 an intended taxable use of at least 90 percent was sufficient.
periodic payments in relation to the progressive or periodic supply of the goods, or the supply of goods or services in the construction, repair, improvement, erection, manufacture, assembly or alteration of goods.”

The third proviso to this subsection is perhaps the closest the law comes to touching on one of the principles discussed above. The proviso states that where a method for determining the ratio has been approved by SARS, that method may only be changed with effect from a future tax period, or from such other date as SARS may consider equitable. “From 1 October 2012, the effective date of any new method cannot be earlier than the beginning of the current financial year in which the ruling application is submitted. Accordingly, SARS no longer has discretion to allow a retrospective apportionment method for a five-year period, as was the case before that date.” The principle of consistency is valid here, preventing a taxpayer from continuously seeking other methods of apportioning its mixed expenses and then wanting to retrospectively apply a new method. This proviso helps in ensuring that methods are applied consistently by vendors and as stated above, SARS will not allow a new method to be applied without a vendor having to rigorously substantiate why the turnover-based method or different method previously approved by SARS does not achieve a fair and reasonable result which is a proper reflection of the manner in which the vendor’s resources (business inputs) are applied for taxable and non-taxable purposes.

Taking the above into consideration all a vendor is left with after interpreting the VAT Act specifically relating to apportionment, is a broad concept of the need to apportion when mixed expenses are incurred. A vendor does not have a method to apply or any guidance on how to apportion its mixed expenses which can be surmised from the VAT Act.

The VAT 404 only makes mention of one allowed method, i.e. a turnover-based method. The turnover-based method’s formula as set out in the VAT 404 and BGR No. 16 is explained below.

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24 Juta’s - RS 9, 2013 JUTA’S VALUE-ADDED TAX 17-12
25 Juta’s - RS 9, 2013 JUTA’S VALUE-ADDED TAX 17-12
26 The formula in respect of the turnover-based method of apportionment constitutes a binding general ruling as contemplated in BGR No.16 (dated 30 March 2015) issued in accordance with section 89 of the TAA and is effective from 1 April 2015 and will remain in force until withdrawn or the relevant legislation is amended.
2.3. Turnover-based method

Formula: \[ y = \frac{a}{a+b+c} \times \frac{100}{1} \]

Where:
- \( y \) = the apportionment ratio or percentage;
- \( a \) = the value of all taxable supplies (including deemed taxable 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” in the formula, which were received or which accrued during the period (whether in respect of a supply or not). (SARS – LAPD, 2015:49)

“(a + b + c) equals the total value of all supplies.”

“Notes:
1. The term “value” excludes any VAT component.
2. “c” in the formula will typically include items such as dividends and statutory fines (if any).
3. Exclude from the calculation the value of any capital goods or services supplied, unless supplied under a rental agreement or operating lease (that is, not a financial lease or instalment sale agreement).
4. Exclude from the calculation the value of any goods or services supplied where input tax on those goods or services was specifically denied.” (SARS – LAPD, 2015:49) “(It is submitted that this exclusion is worded too broadly, as only the supply of goods or services in respect of which input tax was expressly denied under section 17(2) should, logically, be excluded from the formula.)”
5. “The apportionment ratio or percentage should be rounded off to two decimal places.
6. Where the formula yields an apportionment ratio or percentage of 95% or more, the full amount of VAT incurred on mixed expenses may be deducted (referred to as the de minimis rule).
Conditions:
The aforementioned method is subject to the following conditions:

1. The vendor may only use this method if it is fair and reasonable. Where the method is not fair and reasonable or inappropriate, the vendor must apply to SARS to use an alternative method.

2. Vendors using their previous year's turnover to determine the current year's apportionment ratio are required to do an adjustment (that is, the difference in the ratio when applying the current and previous years' turnover) within six months after the end of the financial year.

The turnover-based method is generally calculated using information extracted from the financial statements of the vendor’s business. However, there could be a situation in which the financial statements do not specify the information that is required for the purposes of calculating the turnover-based method (that is, the income statement reflects an amount of income that is made up of both taxable and exempt supplies). Vendors should therefore ensure that if this is the case, adequate accounting records are maintained to establish the actual value of taxable supplies, exempt supplies and other non-taxable receipts.

In practice, it is often difficult to accurately determine the apportionment percentage according to the turnover-based method in each and every tax period. It is therefore acceptable practice to calculate the estimated percentage using the turnover figures from the previous year's financial statements, and to apply that percentage for deducting input tax in each individual tax period for the current year.

An adjustment is made for any shortfall or overestimation in the percentage used for the calculation, when the audited financial statements for the current financial year are available, and the correct percentage can be calculated. It should, however, be noted that this is merely a practical administrative arrangement and does not have the effect of altering any legal provisions in the VAT Act. For example, it does not extend the five-year period in terms of which the deduction of input tax or the claiming of refunds are limited as provided in section 16(3) and Chapter 13 of the TAA. This adjustment should be done within a period of six months after the financial year-end. If the audited financial statements have not been completed within that time, an adjustment should be made using the year-end trial balance figures. This
would be followed by a final adjustment when the audited financial statements for that year are eventually finalised.

For new enterprises with no past financial statements, an estimate based on expected taxable turnover according to the enterprise’s business plan or sales or marketing forecasts could be used. As in the situation above, an adjustment would be required within six months of the financial year-end to account for any differences between the estimated apportionment percentage used, and the actual extent of taxable supplies as determined from the most recent financial statements.” (SARS – LAPD, 2015:50-51)

“Where a vendor has different divisions or cost centres and wants to apply different apportionment percentages for the different divisions or cost centres, a ruling application would have to be submitted to SARS, as such apportionment calculations would deviate from the formula prescribed in the section 17(1).”29 (Juta’s, 2013)

“When calculating the turnover-based apportionment percentage, the following additional arrangements apply:

- a grant received for making mixed supplies (e.g. 30% for exempt public transport and 70% for the taxable supply of water and electricity) must be attributed in terms of s 10(22), thus 30% of the grant must be included in ‘b’ in the apportionment formula, and 70% must be included in ‘a’;
- SARS may consider excluding extraordinary income which may create a distortion in the formula.”30 (Juta’s, 2013)

“While SARS has stated that the turnover-based method may not be used by a vendor if it does not give a fair result in his circumstances, SARS has not limited a vendor’s entitlement to apply the turnover-based method to specific circumstances. It is considered that this basis is inappropriate to calculate the intended taxable use by a vendor who acquires goods or services for taxable and private purposes, as in the case of a home business or a farm with a farm house on it. It is considered that SARS should have prescribed a standard method, using direct attribution on the basis of, say, floor space, for such cases.

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29 Juta’s - RS 9, 2013 JUTA’S VALUE-ADDED TAX 17-7
30 Juta’s - RS 9, 2013 JUTA’S VALUE-ADDED TAX 17-8
Inland Revenue, New Zealand, has prescribed that direct attribution may be used for both taxable or private use and taxable or exempt use, the turnover method may be used only for taxable or exempt use, and, if these methods are not suitable, the vendor may apply to use some other special method (see New Zealand GST Guide (GST 600) December 1997 p 51).

As it is difficult accurately to determine the apportionment percentage according to the turnover-based method in each tax period, it is acceptable practice to calculate the estimated percentage using the turnover figures from the previous year's financial statements. This percentage is then applied for claiming input tax in each tax period during the following year.

An adjustment must be made within six months after the vendor's financial year-end, to account for any shortfall or overestimation in the apportionment percentage used, when the audited financial statements for the current financial year are available and when the correct percentage can be calculated. (Note that, prior to 30 March 2015, the adjustment had to be made within 3 months after financial year-end.) If the audited financial statements have not been completed within the six-month period, the year-end trial balance figures should be used. A final adjustment must then be made when the final figures are available. See VAT 404 para 8.4.3 of the 2015 edition and BGR 16 for further information.

New vendors may apply an estimate of expected taxable turnover according to the business plan or sales forecasts.”

2.4. Necessity of other methods

As stated above the reason why the default method is a method based on the turnover of a vendor, is because there is usually a fairly good correlation between the turnover of a business and the resources (or inputs) which are employed to produce that turnover. The VAT system works on this principle in the sense that VAT charged on supplies made (output tax) less VAT paid to your suppliers (input tax) is equal to the amount of VAT payable or refundable.

31 Juta’s - RS 9, 2013  JUTA’S VALUE-ADDED TAX  17-10
Taking a step back, the VAT Act, in section 23, requires a person carrying on an ‘enterprise’ to register as a vendor *inter alia* “at the end of any month where the total value of taxable supplies made by that person in the period of 12 months ending at the end of that month in the course of carrying on all enterprises has exceeded R1 million”\(^{32}\). (Value-Added Tax Act, No. 89 of 1991, 1991:s23) The VAT Act also defines the term ‘enterprise’ in section 1 by *inter alia* stating that it is “any enterprise or activity which is carried on continuously or regularly by any person in the Republic or partly in the Republic and in the course or furtherance of which goods or services are supplied to any other person for a consideration, whether or not for profit…”\(^{33}\) (Value-Added Tax Act, No. 89 of 1991, 1991:s1) The definition of ‘enterprise’ is very broad, but there are provisos to the definition which excludes certain activities.

*Inter alia* proviso (v) of the definition of ‘enterprise’ deems any activity, to the extent to which it involves the making of exempt supplies, to be excluded from the carrying on of an enterprise. Section 12 lists all the supplies of goods and services which are exempt in terms of the VAT Act. (Value-Added Tax Act, No. 89 of 1991, 1991:s12) Therefore, an entity only making exempt supplies would not be conducting an ‘enterprise’ activity according to the definition and therefore would not be liable to register for VAT. However, when a vendor (i.e. a person registered for VAT as a result of conducting an enterprise activity) also makes exempt supplies, then VAT is only charged, in terms of section 7, on the supply of goods or services in the course or furtherance of any enterprise carried on by him. (Value-Added Tax Act, No. 89 of 1991, 1991:s7) The vendor is only allowed an input tax claim to the extent that the expenses incurred is directly attributable to the making of taxable supplies, in terms of section 17(1). There is a clear link between when input tax is claimable and when output tax is charged and payable. This is where the principle stated above is derived from, the fact that a vendor pays over or receives a refund on the difference between the output tax charged and the input tax claimed for a tax period. (Value-Added Tax Act, No. 89 of 1991, 1991:s17)

It is this principle which supports the use of the turnover-based method in general, as the method clearly calculates the portion of taxable supplies made in relation to the total supplies (including amounts received which are non-supplies) made by a vendor and allows for an input tax claim to the extent of this ratio. In most instances this will result in the portion of input tax claimed on mixed expenses, being a fair and reasonable split between the extent

\(^{32}\) Section 23(1)(a) of the VAT Act

\(^{33}\) Section 1(1) of the VAT Act
to which the said expenses relate to the making of both taxable as well as exempt supplies. Principally this is what the VAT Act tries to achieve, whilst making use of vendors to collect tax on behalf of SARS. In other words a vendor will not be allowed to claim input tax on expenses incurred that does not relate to the making of taxable supplies (i.e. supplies on which the vendor charges output tax). This logic is sound, as it would be to the detriment of the fiscus if the VAT Act allowed persons to register for VAT and claim input tax when the person is not making taxable supplies, i.e. not collecting any tax on behalf of SARS. The above principle is illustrated by the following example.

*Example*

A vendor incurs the following expenses whilst making both taxable and non-taxable supplies in the ratio of 40%:60% (amounts are shown exclusive of VAT):

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Water and electricity (mixed expense)</td>
<td>R500</td>
</tr>
<tr>
<td>Other expenses (directly attributable to the making of taxable supplies)</td>
<td>R1000</td>
</tr>
<tr>
<td>Other expenses (directly attributable to the making of non-taxable supplies)</td>
<td>R2000</td>
</tr>
</tbody>
</table>

Applying the principle that a vendor is only allowed to claim input tax on expenses incurred to the extent of which the expenses relate to the making of taxable supplies, the vendor is allowed an input tax claim as follows:

- Water and electricity
  \[ \text{R500} \times 14\% \times 40\% = \text{R28} \]

- Other expenses (directly attributable to the making of taxable supplies)
  \[ \text{R1000} \times 14\% = \text{R140} \]

- Other expenses (directly attributable to the making of non-taxable supplies)
  \[ \text{R2000} \times 0 = \text{R0} \text{ (no input tax is claimable)} \]

As per the discussion it follows that in the above example the water and electricity expense can be apportioned in the same 40%:60% ratio as the taxable and non-taxable supplies (i.e. the turnover) made by the vendor, where the turnover-based method provides a consistent, fair and reasonable percentage. However, the question which has been asked is, can the above method be used for all sectors in South Africa? Will the turnover-based method always provide a consistent, fair and reasonable percentage in the light of the evolution of certain sectors' businesses and the complexities which accompanies it? The simple answer
is no, as can be clearly determined from all the various methods which SARS has approved over the years. The turnover-based method does not always provide a consistent, fair and reasonable ratio on which input tax incurred on mixed expenses can be claimed.

Therefore, the question that needs to be answered in the context of the higher education sector of South Africa is whether or not the currently applied method, i.e. the varied input-based method, is perhaps the most appropriate method as opposed to the turnover-based method, which was initially applied by the higher education sector when the VAT Act was promulgated, but as a result of universities’ business model changing over the years, have become too difficult to apply, resulting in another method being prescribed by SARS. Other considerations are whether or not there are methods which would provide even more accurate or tax beneficial percentages to vendors within the higher education sector? Or whether or not the higher education sector should be applying its current method in the first place?

2.5. Conclusion

In this chapter the principles of apportionment are laid out in detail, i.e. ‘direct attribution’, ‘consistency’ and ‘fair and reasonable’. The main takeaways from this chapter for each of the principles are as follow: in terms of ‘direct attribution’ you will be required to attribute the VAT expense according to the intended purpose for which the goods or services acquired will be used; in terms of ‘consistency’ the method being applied needs to be applied consistently on a year-on-year basis and the resultant percentage obtained by applying a method consistently, also needs to be consistent.; and in terms of the method being ‘fair and reasonable’, the method must therefore achieve a ‘fair and reasonable’ result which is a proper reflection of the manner in which the vendor’s resources (business inputs) are applied for making taxable and non-taxable supplies respectively.

From the concept of apportionment discussion the main takeaway is that section 17(1) is only applicable to VAT incurred for mixed use purposes and it is these expenses which need to be apportioned. This chapter also discussed the formula of the turnover-based method and concluded by emphasizing the need for other methods. (Value-Added Tax Act, No. 89 of 1991, 1991:s17)

This dissertation will next discuss the input-based method and the apportionment methodology of the higher education sector.
3. Apportionment methodology in the higher education sector

3.1. Introduction

This chapter will discuss the input-based method, as well as its variant which is currently applied by universities, i.e. the varied input-based method. This chapter will also discuss the VCR's issued by SARS to the members of US in terms of the method to be applied.

3.2. Input-based method

Similar to the reasoning of why the turnover-based method is seen by SARS as the most effective method of calculating a percentage, the input-based method is also very effective. As a result of universities not having correctly coded its accounting systems in terms of income streams from taxable and exempt funding, the universities cannot rely on the turnover-based method. Therefore, as an interim measure, SARS had to rely on this other effective method, i.e. the input-based method when it issued the first VCR on 1 August 2012 to the universities. The VCR provides for specific modifications to the input-based method which are unique to universities, which will be discussed later in this dissertation, resulting in the method being a varied input-based method.

The reason why the input-based method is so effective as well, is because there is usually a fairly good correlation between the inputs of a business and the turnover that results from it. In other words the ratio of expenses incurred in the making of taxable supplies to non-taxable supplies, in most instances, gives a fair and reasonable percentage to indicate what portion of the VAT incurred on mixed expenses relate to the making of taxable supplies. The premise is simple, a vendor incurs an expense to generate a specific income. Therefore, if the vendor excludes the mixed expenses from the calculation and bases the percentage on only the expenses which can be directly attributable to either the making of taxable or non-taxable supplies, the vendor will be left with a percentage which, if applied to the VAT incurred on mixed expenses, will provide a fair and reasonable split of the VAT incurred.

“Since the November 2000 tax period a vendor must also obtain specific permission to use the input-based apportionment method, which was a standard method prior to that date. The input-based method was explained as follows in the (withdrawn) VAT 404 2 ed (see para 12.12.2.1 p 73):
According to this method, the proportion of the taxable use of goods or services is calculated by determining the ratio of VAT incurred on goods or services which is wholly attributable to taxable supplies to the total VAT incurred on all goods and services during the tax period and expressing that ratio as a percentage. The resultant percentage reflects the proportion of the taxable use of the goods or services which were partially attributed to making taxable supplies. The following amounts should be excluded from the calculation of the ratio:

- VAT incurred on goods supplied in the same state under an instalment credit agreement;
- VAT incurred on capital goods or services (other than goods acquired for supply under a rental agreement) acquired for use in the enterprise (including any exempt activity);
- VAT incurred on goods or services for which an input tax credit is denied.\(^{34}\) (Juta’s, 2015)

**Example**
During a particular tax period a vendor incurs the following amounts of VAT on goods and services acquired and attributes the use or consumption of them as follows:

<table>
<thead>
<tr>
<th>Total VAT incurred:</th>
<th>R100 000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Attributable as follows:</td>
<td></td>
</tr>
<tr>
<td>- wholly for making taxable supplies</td>
<td>R 40 000</td>
</tr>
<tr>
<td>- wholly for making exempt supplies</td>
<td>R 10 000</td>
</tr>
<tr>
<td>- wholly for purposes of non-taxable activities</td>
<td>R 5 000</td>
</tr>
<tr>
<td>- partially to making taxable supplies</td>
<td>R 45 000</td>
</tr>
<tr>
<td><strong>R100 000</strong></td>
<td></td>
</tr>
</tbody>
</table>

Assuming none of the VAT incurred relates to any of the items which must be excluded from the calculation of the ratio as described above, the proportion of taxable use of the partially attributed goods and services (whether capital goods or services or not) is calculated as follows:

---

\(^{34}\) Juta’s - RS 11, 2015 JUTA’S VALUE-ADDED TAX 17-10B
\[
\frac{\text{VAT wholly attributable to the making of taxable supplies}}{\text{Total VAT incurred}} \times \frac{100}{1}
\]

\[
\frac{40000}{100000} \times \frac{100}{1}
\]

= 40%

40% of the use or consumption of the goods or services which have been indirectly attributed for making taxable supplies.

This concludes the discussion regarding the input-based method. The VCR issued to universities uses this method as basis and makes specific modifications to the method, resulting in a varied input-based method.

3.3. Varied input-based method applicable to universities registered with US

“Most universities primarily provide exempt educational services and are registered as VAT vendors as they make taxable supplies (i.e. standard and zero rated supplies) in addition to exempt and other non-taxable supplies. Taxable supplies include supplies subject to VAT at 14% as well as zero-rated supplies. As a result, universities are required to apportion input tax in respect of those expenses that are not acquired wholly to make either taxable or exempt supplies.” (SARS – LAPD, 2013:1)

Furthermore, the higher education sector’s activities have expanded far beyond the normal supply of educational services for which universities were initially established. One income stream which has become a material source of revenue for the majority of universities is research income in its various forms. This income stream and the way in which it is generated has led to SARS issuing VCRs which explains how SARS treats research in terms of the definition of “enterprise” in section 1 and what impact the revenue generated by research activities has on the apportionment methodology applied by the higher education sector. (Value-Added Tax Act, No. 89 of 1991, 1991:s1)

Broadly the VCRs provides an in depth explanation of research activities in the higher education sector and furthermore provides specific input tax treatment rules for specific types of research activities. Most importantly the VCRs conclude that a portion of the research activities undertaken by universities meet the requirements contained in the definition of “enterprise” in section 1. This has the result that should the input-based method
be applied by universities, consideration needs to be given to the research activities that meet the definition of “enterprise” and specifically the treatment thereof in terms of the formula. (Value-Added Tax Act, No. 89 of 1991, 1991:s1)

The VCRs therefore continue by applying the research activities’ methodology to the input-based method, creating a unique varied input-based method of apportionment for the higher education sector, by including the VAT incurred on research activities which meet the definition of enterprise in the ‘VAT incurred on taxable supplies’ (i.e. ‘a’ in the formula) and the ‘total VAT incurred on research activities’ in ‘b’ in the formula.

The latest VCR issued on 12 March 2015 also discusses change in use adjustments and its various forms in the higher education sector as well the impact of the apportionment method on imported services. Each of the aforementioned topics are discussed in detail.

Introduction in terms of the VCR

“The purpose of the VCR issued by SARS to members of the US is to prescribe the method as contemplated in section 17(1), that universities must use to calculate the amount of VAT to be allowed as input tax in respect of the acquisition of goods or services for a mixed purpose.

A principle of the VAT system is that VAT incurred on the acquisition of goods or services by a vendor in the course or furtherance of making taxable supplies should not be a cost to a vendor unless specifically provided for in legislation. The exceptions provided for in section 12 therefore envisage that VAT incurred to make exempt supplies will not qualify as input tax.

In the instance that a vendor makes both taxable and exempt supplies, it is required to determine the extent to which the goods or services are used, consumed, or supplies in the course of making taxable supplies, as only this portion constitutes “input tax” as defined. In this regard, the determination of the extent to which input tax may be deducted is regulated by the provisions of section 17(1).

The VCR is applicable to all public universities and universities of technology in South Africa which are members of US. Refer to the VCR reference “HESA Ruling” dated 12 March 2015 for the latest list of vendors to which the VCR applies.
A university incurs overhead costs for its benefit as a whole. Where VAT is incurred on goods or services acquired for a mixed purpose, the VAT cannot be directly attributed to either taxable use or to non-taxable use. The VAT is thus neither fully allowed nor fully denied as input tax and must be apportioned in terms of section 17(1).” (SARS – LAPD, 2013:1-2)

Change in use adjustments in terms of the VCR

The latest ruling extension issued (issued on 12 March 2015) in terms of the initial VCR issued on 1 August 2012, explains the interaction between the adjustment (resulting from the difference between the actual apportionment percentage calculated at year end and the previous year’s apportionment percentage applied during the year) and the change in use rules as set out in section 18. (Value-Added Tax Act, No. 89 of 1991, 1991:s8) SARS felt it necessary to explain the interaction as it is an area which easily brings about confusion because of the similarities in the adjustments. There is however a distinct difference between the two adjustments and the way they come about, although this does not affect the way in which the adjustments are accounted for from a VAT perspective. In short the difference can be summarized as follows:

- The percentage applied to capital goods or services acquired as a result of apportionment is an estimated percentage of the taxable use based on the prior year’s percentage. The actual percentage can only be determined after year end. This results in the need for an adjustment, as the estimated percentage applied during the year is not the actual taxable use of the said capital goods or services. However, in the case of a change in use which does not result from apportionment, the adjustment results from the fact that initially the input tax claimed was based on the actual taxable use of the asset and during the year the taxable use changed prompting an adjustment if the provisos allow for it.

Regardless of the reason for the adjustment, the provisos as set out in section 18 applies to both instances and is explained in more detail below. (Value-Added Tax Act, No. 89 of 1991, 1991:s18)

“In the event that capital goods or services are acquired, a vendor is required to estimate the percentage of taxable use in order to deduct input tax as soon as possible after acquisition or importation, despite the fact that the goods or services will be used, consumed or supplied during the subsequent tax periods. Where input
tax has been deducted based on an estimate which does not reflect the actual taxable use, an adjustment must be effected. In the event that the input tax deducted exceeds the input tax that should have been deducted\(^{35}\), as the taxable use of the goods or services has decreased, an output tax adjustment must be made. Alternatively, where the input tax deducted is less than the input tax which should have been deducted, as the taxable use of the goods has increased an input tax adjustment must be affected.

A vendor who acquires capital goods or services wholly or partly for the purpose of consumption, use or supply in the course of making taxable supplies, and subsequently reduces the taxable application or use of such goods or services, shall be deemed, in terms of section 18(2), to make a taxable supply to the extent that there is a decrease in the taxable application or use of such goods or services in relation to its total application. The value of the aforementioned supply is determined by applying the formula as set out in section 10(9), subject to the provisions of that section. This dissertation does not include a discussion of sections 10(9), 16(3)(f), 18(2), 18(5) or 18(6).

Capital goods or services acquired or applied partly for the purpose of the use, consumption or supply in the course of making taxable supplies shall be deemed to be supplied to the vendor in terms of section 18(5) to the extent that there is a subsequent increase in the taxable application or use of the goods or services. In this regard, the vendor shall be entitled to an input tax deduction in terms of section 16(3)(f).

The provisions of section 18(2) read with section 10(9), and section 18(5) are only applicable to capital goods or services where the change in use of such capital goods or services exceeds 10%. The proviso to section 18(2) and (5) further provides, \textit{inter alia}, that an adjustment does not have to be made in the following instances:

- The capital goods or services have an adjusted cost of less than R40 000 (excluding VAT);

- The capital goods or services costs less than R40 000 (excluding VAT); or

\(^{35}\text{The input tax which should have been deducted is determined as a result of calculating the actual apportionment ratio.}\)
The capital goods or services were deemed to be supplied in terms of section 18(4) and the amount, being the lessor of the adjusted cost to the vendor of acquisition, manufacture, assembly, construction or production of those goods, was less than R40 000 when the goods or services were deemed to be supplied to such vendor.

In terms of section 18(6), any adjustment made by the vendor for purposes of section 18(2) and (5) is deemed to take place at the end of the vendor’s financial year.

Universities are required to make adjustments at year-end, in terms of section 18(2) and (5), in respect of all capital goods applied for taxable and mixed purposes where there is an increase or decrease in the taxable application or use of such capital goods. In calculating the adjustment universities must determine the difference between the apportionment ratios for the current and previous financial years (the adjustment percentage) and, insofar as the difference exceeds 10%, apply the adjustment percentage to the VAT paid on acquisition of capital goods.” (SARS – LAPD, 2015:3-4)

Research in terms of the VCR

“Universities primarily supply educational services which are exempt from VAT in terms of section 12(h)(i)(bb) and section 12(h)(ii). Universities have however expanded its services and applied its resources to obtain funding from other sources including services supplied to corporate entities and government.

Research activities in universities are one such component used to increase universities’ funding and global standing. It is however important to ascertain the objective of this research activity to assess whether the VAT incurred would be deductible.

Notwithstanding the meanings assigned to some of the terms in the VAT Act, the VCR defines the following terms:

“applied research” – means a project which is primarily directed towards a specific practical aim or objective and should result in the application of new knowledge into a

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36 The ratio ascertained in “y” of formula in the varied input-based method without applying the limitation of 12.5%.
process or product, or the transfer of existing knowledge into a new process or product, for the benefit of the donor or for the immediate purposes of commercializing the product;

“basic research” – means experimental or theoretical work undertaken primarily to acquire new knowledge of the underlying foundations of phenomena and observable facts, without any particular application or use in view;

“research grant” – means any appropriation of funds by an organ of state within South Africa to a university for the purposes of research where the involvement or development of students is a requirement or condition.

Research projects entered into by a university partly meet the requirements of the definition of “enterprise” at the point when the research activity can be defined as “applied research”.

Universities must apply a fixed percentage to calculate input tax in respect of goods or services acquired for a mixed purpose in relation to research activities.

For the purposes direct attribution, where expenses are incurred for contract research projects and there is no student involvement, these expenses are regarded as being incurred wholly for the purposes of making taxable supplies. Similarly, expenses incurred for basic research projects will be incurred wholly for the purposes of making other than taxable supplies.\(^{37}\)

All expenses incurred in contract research projects in which there is any (including limited or incidental\(^{38}\)) student involvement, as well as projects which meet the definition of “applied research”, whether funded by a donor, a “research grant”, local or foreign grant funding or internal resources are considered to have been incurred for the purposes of making mixed supplies.

\(^{37}\) Refer to as non-enterprise activities in the VCR issued on 12 March 2015 with reference “HESA ruling”

\(^{38}\) A practical example would be if a medical research project makes use of the services of an accounting student to keep track of the expenses that have been incurred on the medical research project. Although the accounting student will have no involvement in the research undertaken, SARS has taken the view that there is still student involvement in such an instance, which will result in the expenses incurred for the research being for mixed purposes.
The VCR prescribes the following percentages to be applied to calculate input tax in relation to research activities:

<table>
<thead>
<tr>
<th>Type of Research</th>
<th>Input tax treatment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic</td>
<td>None</td>
</tr>
<tr>
<td>Applied</td>
<td>50% of input tax deductible</td>
</tr>
<tr>
<td>Contract (student involvement)</td>
<td>50% of input tax deductible</td>
</tr>
<tr>
<td>Contract (no student involvement)</td>
<td>100% of input tax deductible</td>
</tr>
</tbody>
</table>

The VCR furthermore states that it applies to assets of a capital nature (with a value of less than R1 million) which the university purchases for research purposes to the extent that the asset is applied for a mixed purpose, i.e. the apportionment percentage in the above table is to be applied.

Where an asset of a capital nature is acquired for a mixed purpose and the purchase price exceeds either R1 million or if the percentage reflected in the table is not appropriate\(^{39}\), this asset will be subject to a special apportionment method which must be approved by SARS.

The application of the percentages as agreed in the table of the VCR is applicable from the implementation date of 1 April 2012.

The VCR provides a list of research funders along with the research objectives for the projects which the funders fund. In the event that projects are classified as applied research, the normal rules of input tax as envisaged in paragraph (a) of section 7(1) would apply.” (SARS – LAPD, 2013:3-4)

Therefore to re-emphasize the matter, “research undertaken by a university usually involves student participation and/or involvement, research may be partly undertaken for exempt educational purposes and partly for taxable supply purposes. The VAT incurred for both exempt education and standard-rated research purposes must, therefore, be apportioned. To ensure that the same apportionment methodology is applied by all universities, SARS issued the VCR on 1 August 2012 to the members of US. The VCR distinguishes between 'basic', 'applied' and 'contract' research. VAT incurred only for basic research projects is deemed to be incurred wholly for

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\(^{39}\) The percentage is not appropriate in instances where the asset is applied at a rate which varies from the fixed rate, as per the table, by more than 10%.
purposes of making non-taxable (i.e. exempt) supplies. Only research activities which qualify as applied research or contract research are regarded as being carried out in the course of a university’s VAT enterprise. This means that only VAT incurred on the acquisition of goods or services to conduct applied or contract research is incurred for purposes of making taxable supplies. However, where there is any form of student involvement, the applicable percentage to apply is as per the table above.\textsuperscript{40} (Juta’s, 2013)

**General overheads in terms of the VCR**

“In calculating the apportionment percentage on expenses incurred for activities other than research activities, universities may continue to apply the varied input-based method. The VCR sets out the varied input-based method as follows:

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

Where –
“\(y\)” = the apportionment percentage;
“\(a\)” = the VAT incurred wholly for the purposes of taxable supplies made during the period; and
“\(b\)” = the VAT incurred wholly for purposes of all exempt and non-supplies made during the period.

**Notes:**

1. “\(a\)” in the Formula includes:
   - 100% of all input tax incurred in relation to contract research funding where there is no student involvement.
   - 50% of all input tax incurred in relation to “applied research” funded by sources other than contract research.
   - Input tax incurred wholly in the course of making taxable supplies other than research.

2. “\(b\)” in the formula also specifically includes:
   - The VAT incurred on “applied research” activities which is not deductible as input tax as a result of the ruling in respect of research activities’.

\textsuperscript{40} Juta’s - RS 9, 2013 JUTA’S VALUE-ADDED TAX 17-11
3. Exclude from the calculation the input tax on any goods or services acquired where the input tax on those goods or services is specifically denied.

4. Exclude from the calculation any expenses incurred in respect of foreign donor funded projects.

5. Exclude from the calculation expenditure on any capital goods or services acquired, unless under a rental agreement or operating lease.

6. The apportionment percentage should be rounded off to 2 decimal places.

In the instance where the ratio calculated exceeds 12.5% the ratio is limited to 12.5%. However, if the ratio calculated is less than 12.5% the lessor percentage must be applied." (SARS – LAPD, 2013:5)

**Imported services in terms of the VCR**

The latest VCR (dated 12 March 2015) also includes a discussion on imported services. The reason being that output tax declared on imported services will be based on the apportionment percentage calculated by the universities. The discussion on imported services is therefore included in this dissertation for the sake of completeness.

“Universities are required, in terms of section 7(1)(c), to account for output tax at the rate of 14% on the supply of services acquired by the universities from a supplier who is not a resident or carries on business outside of South Africa (foreign services) to the extent that the services are applied for an exempt or non-taxable purpose.

In order to determine what portion of the foreign services are acquired for an exempt or non-taxable purpose (therefore constituting imported services) the taxable portion of the foreign services expense must be extracted. The taxable portion is calculated by applying the apportionment ratio percentage to the actual cost incurred when acquiring these services.

The value of the supply of the imported service is therefore the difference between the actual costs incurred in acquiring these foreign services and the value of the taxable portion.

From 1 April 2014 all foreign suppliers of electronic services (as defined in section 1(1) and prescribed by the Minister by Regulation) supplying electronic services to South African customers, are required to register as VAT vendors and levy VAT at
the standard rate on all supplies made to South African customers. Universities will not be required to account for VAT on imported services in relation to these supplies from such foreign suppliers.” (SARS – LAPD, 2015:8)

Practically, imported services results in an additional adjustment which needs to be calculated and included with the adjustment required to be made within 3 months after year-end as a result of calculating the percentage at year end. The adjustment resulting from imported services can be calculated as follows:

\[ y = a - \left( \frac{a}{b} \times c \right) \]

Where –

- \( y \) = adjustment (payable to) or refundable by SARS
- \( a \) = output tax declared on imported services
- \( b \) = ratio applied during the year (i.e. ratio calculated at the end of the previous year)
- \( c \) = ratio calculated at year end

In conclusion the adjustment includes the following elements: an adjustment calculated on the VAT incurred on non-capital mixed expenses, an adjustment on the VAT incurred on capital mixed expenses (subject to the requirements of section 18(2) and (5)) and an adjustment on output tax declared on imported services. (Value-Added Tax Act, No. 89 of 1991, 1991:s18)

3.4. Conclusion

This chapter discussed the formula of the input-based method as well as the varied input-based method applied by members of US. Furthermore, this chapter discusses the VCR’s issued by SARS which allows for the use of the varied input-based method. This chapter did not make a finding on whether or not the varied input-based method prescribed by the VCRs is effective and appropriate in the higher education sector of South Africa.

This dissertation will next discuss the higher education sector and more specifically the complexities of the sector with regards to its income streams and expense types and the VAT treatment and coding thereof.

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41 This period has been increased to 6 months in the VCR issued 12 March 2015 with reference “HESA ruling” in line with BGR 16 issued on 30 March 2015.
4. Dynamics of the higher education sector

4.1. Introduction

This chapter will discuss the vendors within the higher education sector, i.e. the universities, and specifically its various income streams and expense types, with its corresponding VAT treatment and coding. Furthermore, this chapter will discuss how the intricacies of the aforementioned impacts on the current status of the application of the various methods.

4.2. Income streams and its related VAT treatment and coding

Even prior to the commencement of the VAT Act on 30 September 1991 the higher education sector has been seeking clarity on the treatment of the various supplies made by it in terms of the VAT Act. The first submission in this regard was made on 12 September 1991 in which the Value-Added Tax Committee (“VATCOM”) had to consider whether all educational services should be zero-rated (the VATCOM decided against the application of a zero-rate and rather opted to exempt the supply of educational services). More than two decades later a similar ruling request has been submitted to SARS, as the members of US are still seeking clarity. This is indicative of the fact that consideration needs to be given whether or not to amend the current legislation so that it clearly defines “educational services” in section 12(h)(i) and “goods or services necessary for and subordinate and incidental to the supply of educational services” in section 12(h)(ii). Practically, the turnover-based method cannot be used in the higher education sector until such time as all the income streams can be coded correctly. (Value-Added Tax Act, No. 89 of 1991, 1991:s12)

Following the meeting held in June 2015 between SARS, National Treasury (“NT”) and representatives from professional consulting firms, where the interpretation of section 12(h)(ii) was discussed, it was once again confirmed that clarity is required in respect of VAT implications of the various income streams received by universities. (Value-Added Tax Act, No. 89 of 1991, 1991:s12)

It was suggested that US makes a submission detailing the various income streams and the current VAT treatment thereof in terms of section 12(h)(ii). On 1 October 2015 a ruling
request was submitted to SARS containing descriptions of the income streams received by the higher education sector and the current treatment thereof, requesting SARS to confirm whether it is in agreement with the treatment. (Value-Added Tax Act, No. 89 of 1991, 1991:s12)

In South Africa, most universities are registered as VAT vendors as a result of its taxable activities such as contract research and the letting of facilities which does not fall within the ambit of the exemption in section 12(h). Exempt supplies by universities pursuant to the VAT Act include *inter alia* the supply of educational services and residential accommodation to students. (Value-Added Tax Act, No. 89 of 1991, 1991:s12)

The general view is that if a university charges a fee other than the tuition fee for services supplied to students, and the use of such services is a prerequisite for enrolment at the university then, such services are regarded as part of the supply of educational services, and accordingly, exempt from VAT. Examples include compulsory computer or printing credits and memberships to departmental bodies as a prerequisite of the course for which the student has enrolled. This is also supported by what is reflected on the tuition fee statement to the student.

However, where additional services are supplied by the university and the student has the option of whether or not he or she wants to make use of the service, these services, as a result, are not considered necessary for or subordinate and incidental to the supply of educational services. Accordingly, such services are regarded as taxable supplies for VAT purposes. Examples include optional memberships to sport clubs or cultural societies, additional printing credits and parking fees.

In order to confirm the current VAT treatment of income streams received by the sector, a sample of financial statements and apportionment calculations of universities are reviewed and will be discussed further to illustrate the amount of consideration needed in coding income streams and the various interpretations of the legislation resulting from the limitations in the current legislation. The discussion is split up between the main sources of income of universities, i.e. from educational services, residences, research, investment income and other.
**Income received from the supply of educational services**

The supply of educational services is not defined in the VAT Act. However, the general view is that it is the process of facilitating learning and providing knowledge in an instructive or informative manner. Accordingly the interpretation of what is considered to be educational services for the purpose of section 12(h)(ii) is relatively wide. (Value-Added Tax Act, No. 89 of 1991, 1991:s12)

It is the general view that services supplied by a university and charged to the student together with the tuition fee, on the basis that it is necessary for and subordinate or incidental to the supply of education, should qualify for the exemption of educational services under section 12(h)(ii). (Value-Added Tax Act, No. 89 of 1991, 1991:s12)

Therefore registration, application, the first student card, printing, paper and textbooks as a requirement for enrolment, all constitutes the supply of educational services or necessary and incidental to the supply thereof.

However, if a fee is charged for replacement cards or additional printing and internet credits required by a student, it is the view that these fees do not fall within the ambit of section 12(h)(ii) and therefore not exempt for VAT purposes. (Value-Added Tax Act, No. 89 of 1991, 1991:s12)

In respect of courses and seminars presented by a university, for which no credit is awarded such as a diploma, degree or certificate forming part of a qualification to which the university is willing to put its name to, it is still considered to be the supply of education on the basis that it is a process of facilitating learning and providing knowledge in an instructive or informative manner. Therefore, if a university hosts a seminar or workshop, fees in respect thereof is regarded as exempt educational income.

Below is a table indicating the VAT treatment and coding of the income received by a university as a result of its educational and related activities:

<table>
<thead>
<tr>
<th>Income earning activity</th>
<th>Current VAT treatment</th>
<th>Legislation (applicable section of the VAT Act)</th>
<th>Potential different interpretation of section 12(h)(ii)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Description</td>
<td>Tax Status</td>
<td>Reference</td>
<td></td>
</tr>
<tr>
<td>-----------------------------------------------------------------------------</td>
<td>------------</td>
<td>-----------</td>
<td></td>
</tr>
<tr>
<td>Government subsidy</td>
<td>Exempt</td>
<td>12(h)</td>
<td></td>
</tr>
<tr>
<td>Tuition and related fees in respect of accredited courses, diplomas and degrees</td>
<td>Exempt</td>
<td>12(h)(i) &amp; (ii)</td>
<td></td>
</tr>
<tr>
<td>Fees in respect of workshops or seminars hosted by the university</td>
<td>Exempt</td>
<td>12(h)(i) &amp; (ii)</td>
<td></td>
</tr>
<tr>
<td>Bursaries</td>
<td>Exempt</td>
<td>12(h)(i) &amp; (ii)</td>
<td></td>
</tr>
<tr>
<td>Short courses</td>
<td>Exempt</td>
<td>12(h)(i) &amp; (ii)</td>
<td></td>
</tr>
<tr>
<td>Remark, re write fees</td>
<td>Exempt</td>
<td>12(h)(ii)</td>
<td>s7(1)(a)</td>
</tr>
<tr>
<td>Acceptance and registration fees</td>
<td>Exempt</td>
<td>12(h)(ii)</td>
<td>s7(1)(a)</td>
</tr>
<tr>
<td>Late registration fees</td>
<td>Exempt</td>
<td>12(h)(ii)</td>
<td>s7(1)(a)</td>
</tr>
<tr>
<td>Ticket sales in respect of graduation to non-students</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>Graduation certificates</td>
<td>Exempt</td>
<td>12(h)(ii)</td>
<td></td>
</tr>
<tr>
<td>Graduation in absentia fees</td>
<td>Exempt</td>
<td>12(h)(ii)</td>
<td>s7(1)(a)</td>
</tr>
<tr>
<td>Student records and statements - current students</td>
<td>Exempt</td>
<td>12(h)(ii)</td>
<td></td>
</tr>
<tr>
<td>Student records and statements - alumni students</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>Duplicate certificates</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>Membership fees to departmental bodies as a prerequisite of the course</td>
<td>Exempt</td>
<td>12(h)(ii)</td>
<td>s7(1)(a)</td>
</tr>
<tr>
<td>Lab fees to enrolled students</td>
<td>Exempt</td>
<td>12(h)(ii)</td>
<td></td>
</tr>
<tr>
<td>Lab fees to third parties</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>---------------------------</td>
<td>---------</td>
<td>---------</td>
<td></td>
</tr>
<tr>
<td>Computer and printing fees (compulsory for enrolment)</td>
<td>Exempt</td>
<td>12(h)(ii)</td>
<td>s7(1)(a)</td>
</tr>
<tr>
<td>Fees in respect of non-compulsory computer, printing and class notes</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>Sale of books (not included in tuition fee)</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>Student cards</td>
<td>Exempt</td>
<td>12(h)(ii)</td>
<td></td>
</tr>
<tr>
<td>Replacement cards</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>Re-writing fees</td>
<td>Exempt</td>
<td>12(h)(i) &amp; (ii)</td>
<td>s7(1)(a)</td>
</tr>
<tr>
<td>Examination fees</td>
<td>Exempt</td>
<td>12(h)(i) &amp; (ii)</td>
<td>s7(1)(a)</td>
</tr>
<tr>
<td>Library membership fees - students</td>
<td>Exempt</td>
<td>12(h)(ii)</td>
<td>s7(1)(a)</td>
</tr>
<tr>
<td>Library membership fees - third parties</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
</tbody>
</table>

(PricewaterhouseCoopers, 2015:Annexure C)

**Income from residences**

Section 12(h)(ii) specifically includes the supply by an institution solely or mainly for the benefit of its students including the supply of board and lodging. Accordingly, all income received by a university in relation to student accommodation or meals provided as part of accommodation is an exempt supply pursuant to section 12(h)(ii), “if all of the following conditions are met:

(a) The supplier must be an educational institution mentioned in section 12(h)(i) which supplies exempt educational services, e.g. a school, university, technikon or college.
(b) The goods and services\textsuperscript{44} supplied must be solely or mainly\textsuperscript{45} for the benefit of the educational institution’s learners or students.

(c) The supplies must be necessary for, and subordinate and incidental to, the supply of the educational services mentioned in paragraph (a) above.

When accommodation and meals are supplied to other persons, the supplies will not be taxable as long as the type of supplies usually made with those accommodation units and related facilities are solely or mainly for the benefit of the educational institution’s own learners or students.

Whilst the lodging or board and lodging must be necessary for, subordinate and incidental to the educational services, it is not a requirement that the goods and services must be supplied by the same educational institution. For example, accommodation might be provided at one institution, but lectures may take place at another institution.\textsuperscript{46} It also does not matter if the charges for board and lodging or other items such as study material are itemised separately from the bare tuition fee. The exemption will apply as long as those goods and services are necessary for, subordinate and incidental to the educational services.

When an educational institution supplies accommodation or meals to educators (teachers or lecturers) for no consideration, or for a consideration which does not cover all the direct and indirect costs of making those supplies, the value of supply is deemed to be nil and the educational institution will not be entitled to claim any input tax in this regard (even if it is a vendor for other taxable supplies which it makes). Alternatively, if the meals and accommodation are of the type supplied mainly for the benefit of students, any consideration paid for those supplies is exempt.

\textsuperscript{44} Constituting accommodation, meals and various other supplies in the nature of “domestic goods and services” supplied together with the accommodation.

\textsuperscript{45} The word “mainly” is interpreted to mean greater than 50%.

\textsuperscript{46} The educational institution which provides the education levies the tuition fees taking into account the costs of the entire exempt educational package of goods and services provided to the student or learner in return for those fees. Whether the educational institution is actually able to accommodate or feed the students with its own physical resources or whether it will pay another person to carry out these activities on its behalf is irrelevant for the purposes of applying the exemption.
However, a distinction must be made between goods and services supplied by the educational institution as an integral part of the education, and any other supplies which are made separately and which may be taxable, such as:

(a) Supplies made by the educational institution itself which are not necessary for, subordinate and incidental to the educational services, or which are not solely or mainly for the benefit of students.47

(b) The supply of fixed property under a lease agreement to independent vendors operating on the premises of the educational institution (e.g. a university bookshop or a restaurant)." (SARS – LAPD, 2009:46)

It is however also necessary to deal with the VAT treatment of supplies made to day students and vacation accommodation by a university.

Some of the residences at universities are open to day students to make use of the facility during the day for studying and resting between classes, in some instances meals are also offered to these students. A university usually charges a fee to students making use of this facility. It is the view of certain professional consulting firms that this fee is also exempt in terms of section 12(h)(ii) on the same basis that income received by a university in relation to student accommodation or meals provided as part of accommodation is exempt. (Value-Added Tax Act, No. 89 of 1991, 1991:s12)

In addition during vacation or holiday periods, when the university’s enrolled students have vacated the hostels, universities often provide hostel accommodation for various purposes, at a charge. Such accommodation is typically supplied during June – July (for an average of five weeks) and December – January (for an average of two months).

Vacation accommodation supplied to a student or a third party for no particular educational reason (e.g. for holiday accommodation), does not qualify as an exempt supply under section 12(h)(i) or (ii). It is not educational of nature nor is it necessary for and subordinate and incidental to the supply of educational services. It is therefore a taxable supply of

47 For example, supplies made via vending machines and other coin-operated entertainment devices, rental of sporting facilities and halls for private functions, advertising services rendered in return for sponsorships or other forms of payment, or entrance fees charged to attend sporting events.
accommodation to a third party and subject to VAT at the standard rate. (Value-Added Tax Act, No. 89 of 1991, 1991:s12)

This however excludes the supply of accommodation to the university’s own students during a holiday period for the attendance of a graduation ceremony or the writing of deferred exams. The same view applies to services provided by the university when hosting a seminar, conference, short course or similar event (as principal). It does not matter that the accommodation may potentially be charged in addition to the student’s normal residency fee or that the attendee of the conference or seminar is not enrolled for an accredited diploma or degree. On the basis that the accommodation supplied by the university is necessary for the supply of the educational service, section 12(h) applies and accordingly the consideration received in respect thereof remains exempt. (Value-Added Tax Act, No. 89 of 1991, 1991:s12)

The supply of recreational activities by residences in the view of certain professional consulting firms does not fall into the ambit of section 12(h)(i) or (ii) on the basis that these supplies are not necessary for and subordinate and incidental to the supply of educational services. These supplies typically include supplies of alcohol and beverages by a clubhouse or ticket sales in respect of a house dance hosted by the residence. (Value-Added Tax Act, No. 89 of 1991, 1991:s12)

Below is a table indicating the VAT treatment of the income received by a residence:

<table>
<thead>
<tr>
<th>Income earning activity</th>
<th>Current VAT treatment</th>
<th>Legislation (applicable section of the VAT Act)</th>
<th>Potential different interpretation of section 12(h)(ii)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Student residence fees</td>
<td>Exempt</td>
<td>12(h)(ii)</td>
<td></td>
</tr>
<tr>
<td>Residency application fees</td>
<td>Exempt</td>
<td>12(h)(ii)</td>
<td>s7(1)(a)</td>
</tr>
<tr>
<td>Additional fees to students and to attendees of seminars or conferences</td>
<td>Exempt</td>
<td>12(h)(ii)</td>
<td></td>
</tr>
<tr>
<td>Day student fees</td>
<td>Exempt</td>
<td>12(h)(ii)</td>
<td></td>
</tr>
<tr>
<td>----------------------------------</td>
<td>--------------</td>
<td>-----------</td>
<td></td>
</tr>
<tr>
<td>Vacation accommodation</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td>Exempt in terms of Guide 411, paragraph 6.1.5</td>
</tr>
<tr>
<td>Sale from beverages, other than board and lodging fees</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>Ticket sales (events)</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
</tbody>
</table>

(PricewaterhouseCoopers, 2015:Annexure C)

**Income from research funding and grants**

Pursuant to the VCR issued to members of US, research activities performed by universities, for VAT purposes, are divided into three categories namely, basic, applied, and contract research. Basic research activities, according to the VCR, are not enterprise activities, and accordingly, donations or grant income received to fund basic research activities are exempt for VAT purposes.

Income received for the purpose of performing applied research activities are generally donations or grant funding form a Government Department and therefore either exempt or zero rated in terms of section 8(5A) read with the definition of a grant and section 11(2)(t). Income received for the purpose of applied research activities are only zero rated to the extent that is applied by the university for enterprise activities, generally in terms of the VCR 50% is regarded as taxable at zero percent and 50% exempt on the basis that it received for educational purposes. (Value-Added Tax Act, No. 89 of 1991, 1991:s8, 1991:s11)

Universities also receive research funding from the Department of Trade and Industry for Technology and Human Resources for Industry Programme (“Thrip”). Thrip is a joint venture between industry, research and educational institutions and Government to support the development of technology and appropriately skilled people for industry to improve South Africa’s global competitiveness. Thrip performs the task of providing resources and mechanisms in support of collaborative research in areas of science, engineering and technology.
Thrip support is limited to higher education institutions and Science, Engineering and Technology Institutions ("SETI"). Thrip will only support projects that promote and facilitate scientific research, technology development and technology diffusion or a combination of these. At least one university and one industry partner must be involved. The industry partner must give a clear indication that the research project will benefit them directly.

The payment of Thrip funds is made by the National Research Foundation ("NRF") as management and administration agent of Thrip on behalf of the DTI.

Generally the parties will agree to all contribute to the project, Thrip provides R2 for every R1 by the industry partner. The contribution from Thrip by the DTI through the NRF, is subject to VAT at the rate of zero percent in accordance with section 8(5A) read with section 11(2)(t). However the zero rating will only apply to the extent that the university applies the funding towards its enterprise activities, otherwise it is exempt. The contribution by the industry party should be subject to output tax at the rate of 14% on the basis that the industry partner will receive a benefit from the research performed by the university. (Value-Added Tax Act, No. 89 of 1991, 1991:s8, 1991:s11)

Sub-contracting agreements between the Science Councils and other universities are also common in the sector. Typically the arrangements are made when an institution being either the Science Council or the university is awarded a grant for a specific research project, and the grant recipient does not have the capacity to perform the research and therefore appoints another university to perform in terms of the grant agreement. It is the view of certain professional consulting firms that these arrangements constitute the supply of a service and therefore subject to output tax at the rate of 14%. The zero rating provisions in respect of grant funding may not be relied upon on the basis that the university where the project is subcontracted to will be rendering a service to the grant recipient.

When a collaborative research project is awarded to multi institutions and the grant is paid to the main recipient for distribution to other institutions listed in the grant agreement, there is no supply between the institutions and therefore the funding distributed amongst the institutions will not be subject to output tax.

The last category of research referred to in the VCR relates to contract research. In this instance, the university will agree on a deliverable with the funder, and will have to account for output tax on the consideration received at the rate of 14 percent unless an exception
applies. Typically this includes commercial funding and sub-contracting agreements with other universities or science councils.

Below is a table indicating the VAT treatment of the income received for research activities:

<table>
<thead>
<tr>
<th>Income earning activity</th>
<th>Current VAT treatment</th>
<th>Legislation (applicable section of the VAT Act)</th>
<th>Potential different interpretation of section 12(h)(ii)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic research funding</td>
<td>Exempt</td>
<td>VCR &amp; s12(h)</td>
<td></td>
</tr>
<tr>
<td>Applied research funding</td>
<td>Exempt or zero rated</td>
<td>VCR &amp; s12(h)</td>
<td></td>
</tr>
<tr>
<td>Thrip funding:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- DTI/NRF</td>
<td>Exempt or zero rated</td>
<td>s8(5A) and s12(h)</td>
<td></td>
</tr>
<tr>
<td>- Industry partner</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>Sub-contracting arrangements</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>Collaborative research grants</td>
<td>Exempt or zero rated</td>
<td>s8(5A) and s12(h)</td>
<td></td>
</tr>
<tr>
<td>Contract research funding</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
</tbody>
</table>

(PricewaterhouseCoopers, 2015:Annexure C)

**Income from investment**

Section 2 provides for the exemption of income received from the supply of financial services such as interest received. Accordingly, income received by universities such as interest and dividends are exempt or seen as a non-supply for VAT purposes. (Value-Added Tax Act, No. 89 of 1991, 1991:s2)

**Income from the supply of goods and services not related to educational activities**

Other than the supply of educational services and research activities, universities also receive income from other activities such as membership fees from sports clubs and
societies. It is the general view that these supplies are not necessary for or subordinate or incidental to the supply of educational services, and as such, do not fall within any of the exemptions in section 12(h). Therefore unless an exemption or exception other than section 12(h) applies, income received by a university in respect of these supplies will be subject to output tax at the standard rate of 14%. (Value-Added Tax Act, No. 89 of 1991, 1991:s12)

Below is a table indicating the VAT treatment of the income received for other activities:

<table>
<thead>
<tr>
<th>Income earning activity</th>
<th>Current VAT treatment</th>
<th>Legislation (applicable section of the VAT Act)</th>
<th>Potential different interpretation of section 12(h)(ii)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-compulsory membership fees</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>- Sports clubs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Gym membership fees</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Cultural societies</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Parking</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>Commission</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>Letting of facilities to third parties</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>Fines</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>Health services or clinic</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>Student counselling and testing services</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>Sale of promotional items and gifts</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>Sale of theatrical productions and art projects</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>Ticket sales to sport or cultural event</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>Disposal of educational assets</td>
<td>Exempt</td>
<td>12(h)(ii)</td>
<td></td>
</tr>
<tr>
<td>Disposal of other assets, e.g. sporting equipment by sports</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>Description</td>
<td>Taxable/Exempt</td>
<td>Section</td>
<td></td>
</tr>
<tr>
<td>--------------------------------------------------</td>
<td>----------------</td>
<td>---------</td>
<td></td>
</tr>
<tr>
<td>Farm sales such as livestock</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>Income from staff crèche</td>
<td>Exempt</td>
<td>12(h)(ii)</td>
<td></td>
</tr>
<tr>
<td>Part time music and dance classes</td>
<td>Exempt</td>
<td>12(h)(ii)</td>
<td></td>
</tr>
<tr>
<td>Fees from reunion and alumni events</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>Student transport services</td>
<td>Exempt</td>
<td>12(h)(ii)</td>
<td></td>
</tr>
<tr>
<td>Tender application fees received</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>Fees from consulting services to third parties</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>Laundry fees not charged as part of residency fees</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>External income from restaurant or catering facility</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
<tr>
<td>Marketing services</td>
<td>Taxable</td>
<td>s7(1)(a)</td>
<td></td>
</tr>
</tbody>
</table>

(PricewaterhouseCoopers, 2015:Annexure C)

**Current status of the application of the turnover-based method**

It is clear from the aforementioned discussion in this chapter that the universities face an immense task to not only identify the various income streams, but also code it correctly in terms of the VAT Act and the VCR. The additional complexities which arose since universities increased its research activities and along with it, its sources of funding, has made the application of the turnover-based method near impossible.

One specific problem which universities currently have, is the way in which its accounting systems are set up. The accounting systems do not have the facility or is not set up in a way in which to distinguish between the various sources of funding universities may receive for research purposes. This inhibits the coding of research income, which is necessary in order to determine the percentage. An example of the difficulty is for instance in a case where a university receives funding from Thrip and utilizes it in applied research. Currently, universities will account for a single amount received. However, this amount would be made up of an amount received from government and an amount received from the industry...
partner. Although the amount may be used for the same research, from a VAT perspective, the following will apply:

- The portion received from the government would be zero-rated in terms of section 8(5A) read with section 11(2)(t) to the extent that the grant has been paid to the university in the course or furtherance of an enterprise carried on by it, i.e. as per the VCR this would only be 50% of the research as a result of student involvement. The other 50% of the grant received would be a non-supply for VAT purposes. (Value-Added Tax Act, No. 89 of 1991, 1991:s8, 1991:s11)

- The total funding received from the industry partner will be subject to VAT at 14 percent.

In the above example the total funding received from Thrip (i.e. the government and industry partner's portions) will be included in the denominator (either 'a' or 'c') in the formula. However, only 50% of the funding received from the government along with the total funding received from the industry partner will be included in numerator ('a') in the formula.

The members of US have identified the aforementioned difficulties in applying the turnover-based method and have informed SARS, who has resultantly decided to allow for the temporary use of a varied input-based method. SARS has however stated in the VCR's issued to the members of US that it wants the universities to correctly code its income streams and subsequent to that SARS will again consider the most appropriate method for the higher education sector.

4.3. Expense types and its related VAT treatment and coding

Since the initial VCR issued to members of US came into effect on 1 April 2012, which requires the application of the varied input-based method, universities had to code its various expenses, expense types, cost centers, etc. whichever is applicable in order to apply the varied input-based method.

SARS prescribed this method as it is a very effective method in most sectors as discussed previously, but unfortunately it poses similar difficulties as with the turnover-based method, with regards to its application in the higher education sector.
Most universities use a system consisting of cost centers to which expenses are allocated. Each university using cost centers, has its own reasoned logic for determining whether or not to open a new cost center or to use an existing one when, for instance, a new research contract is entered into. Each university also has its own allocation basis for allocating expenses to cost centers. The differing logic followed by the universities in terms of when to open a new cost center as opposed to using an existing cost center, is one of the major problems experienced whilst applying the varied input-based method.

Furthermore, universities make use of thousands of cost centers each and naturally each cost center needs to be coded individually for apportionment purposes. Depending on the logic used in opening cost centers, further work is required to sometimes split the expenses allocated to a cost center, as the cost center might be used for multiple projects which have different VAT treatments.

**Expenses relating to research funding and grants**

Continuing from the income stream discussion relating to research funding and grants and its accompanying VAT treatment and coding, expenses incurred needs to be allocated, where possible, to the income from various research funding and grants. Depending to what the expenses can be directly attributable to, will determine where the VAT incurred on these expenses will be included in the formula. Alternatively, the VAT incurred will be coded as mixed and will excluded from the formula.

For example a university A could open a cost center for each research project it enters into. This will result in many more cost centers to code, i.e. more time required and more costly, but one would obtain a very accurate coding result, as each project can be coded specifically with regards to each project’s contract. University B could open cost centers per professor, and the said professors then uses their cost centers for all their research undertaken. This would result in less cost centers to code, i.e. less costly, but simultaneously decrease the accuracy of the coding, as a result of the difficulty in splitting the expenses per research project, and also the fact that coding errors could be made whilst looking at multiple research projects combined in one cost center. University C could open cost centers per research funding source, this again would have the effect of less cost centers, but increase the difficulty of coding, because even though the funding comes from the same source, the research might differ, i.e. for example basic versus applied research, resulting in a different outcome for VAT purposes in terms of the VCR.
Expenses relating to the supply of educational services

The above example is an illustration of one of the difficulties of coding research cost centers. Similar difficulties are however present, although it is usually to a lesser extent, in cost centers related to non-research activities. For example a university opens cost center A for printing expenses incurred internally by the university. The same university also outsources the majority of the printing, i.e. textbooks and other material used in the supply of educational services, to a third party, these expenses are allocated to a separate cost center B. Clearly cost center B’s expenses will be coded as exempt as it directly relates to the making of exempt supplies and will be included in the denominator (‘b’) of the formula. However, cost center A’s coding is much more contentious and therefore difficult, as the expenses allocated to this cost center can potentially be attributable to various supplies and non-supplies. Firstly, the printers used internally by the university are used by students, who either receive a set amount of printing credits at the beginning of the year as part of their tuition fees paid, or buys additional printing credits. Secondly, university staff use printers for various purposes, for example exam papers, lecture notes, research results, personal use, etc.

By following the principles of apportionment one first has to consider whether cost center A’s expenses can be directly attributable to the making of either taxable, exempt or non-supplies. As the printers are used by students who for instance have bought additional printing credits, i.e. not printing credits which are received as part of tuition fees, that portion of the expense is related to the making of taxable supplies (refer to the income stream discussion). The portion of the expenses incurred relating to a student using the printing credits received as part of tuition fees, will relate to the making of exempt supplies. Furthermore, the portion of the expenses incurred by university staff using the printers for no consideration and for multiple purposes could be argued in varying ways. Clearly the expenses allocated to cost center A in our example cannot be directly attributed and therefore has to be apportioned by means of a method that is applied consistently and results in a fair and reasonable apportionment.

The fact that the expenses of cost center A needs to be apportioned implies that it is a mixed expense. In terms of the treatment of mixed expenses in the varied input-based method, the expenses are excluded from the formula and the percentage obtained from the formula is then applied to the VAT incurred on these expenses, to determine which portion a university may deduct as input tax. In terms of the VCR’s this percentage is limited to 12.5%. This is a further problem for certain universities. Taking the previous example into account, the fact
that the majority of the printing expenses attributable to the making of exempt educational supplies have been allocated to a separate cost center B, results in a much larger portion (i.e. a percentage higher than 12.5%) of the expenses allocated to cost center A being incurred in the making of taxable supplies, i.e. the selling of additional printing credits to students. In most instances the 12.5% limit will prohibit universities from claiming the total portion of VAT incurred relating to the making of taxable supplies.

There is no easy solution for this, as in terms of the varied input-based method the universities have to code cost center A in the example as mixed, thereby limiting the input tax deduction to 12.5% on the VAT incurred on expenses allocated to this cost center. Should universities want to prevent this from happening, they will need to open additional cost centers and allocate the expenses more accurately to reflect which portion of the expenses are incurred, for instance, to students buying additional printing credits and expenses incurred on students using printing credits which have been allocated to them as part of their tuition fees. Of course such an endeavor is near impossible, as the expenses are usually incurred simultaneously (for instance the buying of paper cannot always be split into paper being used by students who bought additional printing credits and students who use printing credits obtained as part of their tuition fees). Therefore, the result of the aforementioned is in some instances unfair towards the university and any attempt, if one can be found, to allocate expenses more accurately would be extremely time consuming and result in additional costs to universities.

**Expenses relating to residences**

Another example of coding difficulty can be found in cost centers relating to residences. A university could have a cost center A relating to a specific residence. To this cost center the university could allocate all the expenses incurred by that specific residence, this could include for example the expenses related to: residential accommodation or vacation accommodation, residency functions (for which fees could be charged or not), bar expenses, etc. The same coding principles as discussed in the income stream discussion are applied here, and even though the varied input-based method considers expenses incurred, one needs to allocate (if possible) the expenses to the relevant income streams. In the example the expenses would be coded as mixed as cost center A would receive exempt income in the form of residency fees, as well as taxable income for the vacation accommodation, tickets to residence functions, bar sales.
In such cases a coding of “mixed” could benefit a university, where a university does not have a lot of ancillary income streams which are taxable relating to residences (i.e. less than 12.5% taxable supplies). This is not to be confused with the VCR which explicitly states that “if the ratio calculated is less than 12.5% the lessor percentage must be applied.” (SARS – LAPD, 2013:5) Remember that if an individual cost center makes taxable supplies of less than 12.5%, but cannot be directly attributable to the making of specifically either taxable, exempt or non-supplies, it will be coded as mixed. If the overall percentage calculated by the university is more than 12.5%, then the percentage is limited to 12.5% and applied to all the cost centers coded as mixed. This creates the scenario where VAT incurred on mixed expenses, in a specific cost center which makes less than 12.5% taxable supplies, can still be claimed at 12.5%.

Alternatively, universities which make a lot of taxable supplies (i.e. taxable supplies of more than 12.5%) relating to its residences, would not want to be limited to a 12.5% deduction of VAT incurred. Such universities would then create more than one cost center, to more accurately allocate expenses per activity. In such instances where the university has made use of separate cost centers, the university has the benefit of direct attributing the expenses to the making of either exempt, taxable or non-supplies. For example a university which has created a cost center specifically for residency functions for which it sells tickets, will be able to claim 100% of the VAT incurred on expenses for the functions (as the expenses are directly attributable to the making of taxable supplies, i.e. the ticket sales).

Clearly from the above examples, universities consider what the best option is for its specific activities. SARS considers this in light of the principles of apportionment. However, it could be very easily determined that this does not result in apportionment which is applied consistently and results in a fair and reasonable outcome in the higher education sector. This is understandable as SARS takes a holistic view of the sector when determining the most effective and appropriate method. A university will of course be at liberty to apply for a separate VAT ruling from SARS if it feels that its business model and specific activities, are significantly different or negatively impacted by the prescribed method of SARS.

**Expenses relating to the supply of goods and services not related to educational activities**

The discussion to this stage has only related to the allocation of expenses to cost centers and the coding of the cost centers. However, cost centers are but one element that one needs to consider when coding expenses of universities in terms of the varied input-based
method. Another difficulty is identifying the expenses for which input tax deductions are disallowed in terms of section 17(2)\textsuperscript{48}. (Value-Added Tax Act, No. 89 of 1991, 1991:s17)

These expenses, especially entertainment expenses, are incurred by virtually every cost center of the university, i.e. it is not allocated to one cost center, which could then just be identified and excluded from the formula. Therefore, subsequent to coding each cost center one has to identify within each cost center entertainment expenses that are specifically denied in terms of section 17(2). There are various exceptions to this section (section 17(2)(a)) which have to be taken into account as well. (Value-Added Tax Act, No. 89 of 1991, 1991:s17)

For example a university could have a restaurant or catering division for which a cost center has been set up. The restaurant could sell its products to customers who order from a menu, buy takeaways, etc. (VAT incurred will be claimable as it has been acquired by the restaurant for making taxable supplies of entertainment in the ordinary course of an enterprise which continuously or regularly supplies entertainment to customers) or alternatively supply meals to residences which forms part of the board and lodging provided by the university to the students (the VAT incurred will not be claimable as it has been acquired in the making of exempt supplies) or it could supply food for university staff functions for no consideration (the expenses incurred in this regard would fall into the definition of entertainment as per section 1, and result in the input tax deduction being denied in terms of section 17(2)). (Value-Added Tax Act, No. 89 of 1991, 1991:s17)

Similar to the previous example relating to the cost center created for a residence, the cost center created for the restaurant or catering division will result in much consideration for a university. If the cost center makes less than 12.5% taxable supplies (i.e. restaurant sales from a menu or takeaways) it would not mind coding the cost center as mixed, as in the event that the overall percentage calculated by the university exceeds 12.5%, it will be allowed an input tax deduction limited to 12.5% of the VAT incurred on the expenses allocated to the restaurant or catering division cost center. However, if the restaurant makes more than 12.5% taxable supplies the university would want to set up more than one cost center to split the expenses incurred according to the taxable supplies and the exempt supplies made by the restaurant or catering division, so as to ensure that 100% of the VAT incurred on expenses relating to the making of taxable supplies is recovered.

\textsuperscript{48} Section 17(2) \textit{inter alia} denies an input tax deduction in respect of entertainment and acquisition or use of certain motor cars. It also provides for some exclusions to the rule, for example, where entertainment is the main business of the vendor.
The aforementioned concerns and considerations might be clear, but in light of the fact that the VAT incurred on expenses which are denied (in terms of section 17(2)) must be excluded from the formula, adds an additional element of difficulty. In the example the VAT incurred on expenses to cater for staff functions for no consideration, would fall into the definition of “entertainment” as per section 1 and should be excluded from the formula. The VAT incurred on the expenses to cater for the residences which result in the making of exempt supplies by the university to the students, could be included in ‘b’ in the formula, alternatively, it could be argued that if the residences pay the restaurant or catering division for the food, that it is a taxable supply made by the restaurant or catering division, despite the residences and the restaurant forming part of the same vendor and the payment being internal to the university. This will result in the VAT incurred on expenses for the residences being attributable to the making of taxable supplies which will be included in ‘a’ in the formula. As one can clearly see, the VAT incurred could potentially impact the numerator, denominator, mixed expenses or have no impact at all. (Value-Added Tax Act, No. 89 of 1991, 1991:s1, 1991:s17)

Combined with the aforementioned, the expenses incurred by the restaurant or catering division usually occurs simultaneously (for instance the buying of a pocket of potatoes cannot always be split into potatoes being used for staff catering for which no consideration has been received and potatoes being used for student catering).

Therefore, the result of the aforementioned is in some instances unfair towards the universities, just as in the example of the printing cost center, and any attempt, if one can be found, to allocate expenses more accurately would be extremely time consuming and result in additional costs to universities.

To identify and isolate other types of input denied expenses in terms of section 17(2), such as expenses incurred on motor cars, is usually easier, as effective searches of a data dump of all the transactions of a university for the year should result in the majority of these expenses being identified. Searches could be made for specific supplier names for instance, such as Avis, Europcar, Budget, etc. The VAT incurred on these expenses is simply excluded from the formula. (Value-Added Tax Act, No. 89 of 1991, 1991:s17)
Current status of the application of the varied input-based method

Currently a difficulty universities experience is a lack of staff members who have the required knowledge to apply the correct VAT coding once a transaction is captured. This results in time wasting when attempting to code the transactions according to the varied input-based method as one has first to investigate what the nature of certain transactions are, so as to accurately code the expense. Some universities have a dedicated VAT specialist which is appointed to ensure that transaction coding and expense allocation happens correctly as far as possible. This results in a much more effective and less costly process come year end, when the percentage and the accompanying adjustment needs to be calculated.

Currently the majority of universities just do not have the capacity and knowledge to calculate the yearly percentage and therefor have to make use of professional consulting firms to perform the calculations on its behalf. This is extremely expensive and preferably needs to be avoided if possible by calculating the percentage and adjustment in-house. A professional consulting firm could then be contracted to only check the logic and accuracy of the final calculations.

In terms of actual calculations a further significant problem has arisen. A combination of the costs necessary to pay professional consulting firms to perform the calculations and the difficulty in calculating the percentages have resulted in calculations falling behind and taking more than a year to complete. The varied input-based method is definitely not the long term solution, and at the current rate even if a solution is found immediately, the latest ruling extension application of the VCR requests an extension of the use of the varied input-based method until the end of 31 December 2017.

4.4. Conclusion

In this chapter the various income streams and expense types of universities are discussed in detail, along with the VAT treatment and coding thereof. Furthermore, the practical difficulties surrounding the application of the available methods are discussed. It is concluded that the varied input-based method is definitely not the long term solution as the difficulty in its application and the financial burden makes it impracticable to use.

This dissertation will lastly look at possible other solutions as well as the latest developments within the higher education sector.
5. Considering other solutions and latest developments

5.1. Introduction

This chapter will discuss the possible solutions to the current difficulty experienced by the higher education sector in terms of deciding on the best way forward.

Furthermore, this chapter will also discuss the latest developments in the higher education sector from a VAT apportionment perspective.

5.2. Considering other solutions

It is clear from the chapter on the “Dynamics of the higher education sector” that as a result of the intricacies of the universities’ business models, it is highly unlikely that a current method or even a new method will be developed which will be able to simplify, but still accurately calculate the yearly percentage. Even if a method could be developed which suits one university, it is very likely not going to suit another. For example universities in South Africa can be split into research intensive universities and universities which have minimal research activities.

The difference between these two groups of universities can clearly be seen in its revenue streams. A research intensive university’s research funding provides for millions of more Rands to spend each year, as opposed to a university with minimal research activities. Therefore, any turnover-based method will not result in a fair and reasonable result across the higher education sector, as research intensive universities’ percentage tend to be far higher than those which have minimal research activities. Resultantly, research intensive universities will receive more money from its yearly VAT adjustment.

If one takes the argument further, the expenses incurred by research intensive universities as opposed to universities with minimal research activities, will be proportionately different, as the research intensive universities will have more expenses which relate to enterprise activities, i.e. to the making of taxable supplies, because of the possibility of undertaking contract research or applied research. When an input-based method is then applied across the higher education sector the percentages are likely not to be fair and reasonable as such a method will benefit the research intensive universities, i.e. its percentages will be higher than the universities with minimal research activities, resulting in a larger financial benefit to the research intensive universities.
Unfortunately, it is also the research intensive universities that are in a financially stronger position than the universities with minimal research activities, for obvious reasons of course, to name but one is the research funding received. Although universities play a major part in being at the forefront of research worldwide, in a South African context the need for education outweighs the need for research. As the majority of people in South Africa are uneducated, it is of the utmost importance that, not just more primary and secondary schools are built, but that the tertiary institutions are used to its maximum capacity to educate the nation. The benefits of a more educated society is obvious and does not need to be reiterated.

It is therefore necessary, from a VAT perspective, to consider other solutions. Solutions which will result in a fair and reasonable outcome across the sector. This might well mean, that instead of the continuous search for a method which could somehow provide a consistent, fair and reasonable result, that other options are considered. Options which do not result in an apportionment position, and which takes away, not only the difficulty of calculating a yearly percentage, but lessens the financial burden.

Section 17(1) will result in an apportionment position for the higher education sector as universities make both taxable and exempt supplies as discussed previously. Furthermore, universities incur mixed expenses and in order to recover a portion of the VAT incurred on these mixed expenses, apportionment is the only option in terms of the VAT Act, if the supply of educational services remain exempt. Therefore, in order to find a solution that does not involve apportionment consideration needs to be given to changing the legislation, more specifically section 12(h). Potential solutions are discussed in the next part. (Value-Added Tax Act, No. 89 of 1991, 1991:s12, 1991:s17)

5.2.1. Reduced rate

Before this option is discussed in more detail, it is important to reiterate that as a result of section 12(h), which exempts the supply of educational services, the universities are not allowed to claim all the VAT incurred on expenses. This combined with the universities making taxable supplies results in an apportionment position for the universities in terms of section 17(1). If section 12(h)'s application to universities is removed from the VAT Act, it will result in the supply of educational services by universities to be taxable. (Value-Added Tax Act, No. 89 of 1991, 1991:s12, 1991:s17)
This would mean that universities would be able to claim the VAT incurred on all its expenses, unless of course universities make another form of exempt supply for which expenses are incurred (this is however not discussed in this dissertation). Therefore, should the supply of educational services be taxable in terms of the VAT Act, no apportionment position would arise in terms of section 17(1). This would immediately alleviate the financial burden of appointing professional consulting firms or someone internally to calculate the percentage. It would also remove all the difficulties experienced in performing the actual calculation, which as stated previously, could easily take more than a year to finalise. (Value-Added Tax Act, No. 89 of 1991, 1991:s17)

Prima facie this seems fair and reasonable as it would result in universities being able to claim the VAT incurred on its own expenses and also to the extent that each university incurred expenses. Even it can be argued that it benefits the research intensive universities more (because it incurs more expenses and will resultantly have more VAT incurred to reclaim), it at the very least will not directly result in an unfair benefit for the research intensive universities. Such as in the instance of the current apportionment situation, where the more research intensive universities are able to claim a larger portion of VAT incurred purely as a result of having received more research funding, and the less research intensive universities are left with the VAT incurred being an expense.

This is as a result of the research intensive universities having higher percentages, as opposed to the less research intensive universities. In other words if all the universities could claim its own VAT incurred back in full, the fact that some universities are more research intensive as a result of more research funding will become irrelevant and take away the unfairness thereof.

There are various issues to consider before making educational services supplied by universities taxable and thereby allowing a claim to all VAT incurred. Some of the main issues are the following:

- Additional costs for students if VAT is levied on the fees;
- Loss to the fiscus if universities are allowed to claim more VAT incurred as a result of it only making taxable supplies; and
- Loss to the universities if fees are not increased but a portion of it needs to be paid over to SARS as output tax.
A possible solution to the problem would be a reduced yearly grant by government to universities, to the extent of the potential loss to the fiscus. Currently, government provides a yearly grant to each university based on set criteria. For the sake of keeping the argument as simple as possible, consider the following example:

**Example (figures are rounded in the example)**

- The supply of educational services is taxable at a rate of 14%;
- University A receives a yearly grant of R1 billion (based on government criteria);
- University A incurs VAT on mixed expenses to the amount of R10 million for 2015 and has an apportionment percentage of 25% in 2015.

University A will be able to claim the VAT incurred on mixed expenses as follows:

\[10 \text{ million} \times 25\% = R2.5 \text{ million (VAT claim on mixed expenses)}\]

If section 12(h) is amended and the supply of educational services are made taxable, University A would be allowed a claim of the full R10 million, i.e. a loss to the fiscus of:

\[10 \text{ million} – 2.5 \text{ million} = R7.5 \text{ million}\]

If the concept of a reduced grant is applied, government would pay University A a reduced grant of:

\[1 \text{ billion} – 7.5 \text{ million} = R992.5 \text{ million}\]

The reduced grant which government pays, compensates for the higher input tax deduction University A would have if the supply of educational services are made taxable. Taking nothing else into consideration, there would then be no loss to the fiscus or the university and at the same time University A would not have the burden of calculating a yearly percentage.

Again, conceptually the above solution seems simple and effective. The problem with it, is that it makes use of University A’s percentage for the 2015 year to determine by how much the grant needs to be reduced. This implies that a percentage is still necessary in order to determine the reduced grant. This clearly defeats the object and a possible solution would
be to calculate a reduced VAT rate (“reduced rate”), which would also result in no loss to the fiscus or the universities and remove the burden of apportionment.

Before illustrating the effect of a reduced rate by way of an example, it is discussed conceptually. If the supply of educational services are made taxable, SARS would be able to collect additional VAT. However, in the context of South Africa, and the current student protests against fees, the last thing that government would want is to increase fees by 14%. Remember the reason supply of educational services is exempt, is to not burden the student's with tax, and thereby reduce the cost of education in South Africa. Therefore, if the supply of educational services are to be made taxable, i.e. VAT at 14% will be levied on it, a method needs to be devised to ensure that the 14% increase does not become an additional cost for the students. The following example illustrates this:

**Example (figures are rounded in the example)**

- The supply of educational services is taxable at a rate of 14%;
- University B receives a yearly government grant of R1 billion;
- University B receives fees of R500 million (excluding VAT) a year;
- University B incurs VAT on mixed expenses to the amount of R10 million for 2015 and has an apportionment percentage of 25% in 2015.

If supply of educational services are made taxable at 14% the additional costs to the students would be:

\[
500 \text{ million} \times 14\% = R70 \text{ million} \quad \text{(SARS would also collect this amount as additional output tax)}
\]

As government and the universities do not want any additional costs for students the best option would be to keep the current fees as is, i.e. R500 million, and make it a VAT inclusive fee as follows:

\[
500 \text{ million} / 114 \times 100 = R438.5 \text{ million} \quad \text{(this would be the universities fees excluding VAT)}
\]

\[
438.5 \text{ million} \times 1.14 = R500 \text{ million} \quad \text{(therefore the total cost for the students would remain R500 million for the year, i.e. no additional costs to the students and no apportionment calculation for the universities)}
\]
SARS would collect an amount as additional output tax and the universities would lose this amount in fees:

\[500 \text{ million} - 438.5 \text{ million} = 61.5 \text{ million}\]

Furthermore, previous problem also plays a part, the students does not have additional costs, but in terms of the additional input tax deduction on mixed expenses SARS would be at a loss and the universities would be at a gain, as follows:

\[10 \text{ million} \times 25\% = 2.5 \text{ million}\] (University B previously would only have been allowed to claim this amount of VAT incurred on mixed expenses)

Now University B will be allowed to claim the full R10 million VAT incurred as it does not make any exempt supplies, i.e. all its expenses are incurred in the making of taxable supplies, as follows:

\[10 \text{ million} \times 25\% = 7.5 \text{ million}\] (SARS would be at a loss if section 12(h)’s scope is reduced to exclude universities)

The net position if the supply of educational services are made taxable at the standard rate for the three parties involved in the example (government or SARS or fiscus, universities, students) can be set out in the following table:

<table>
<thead>
<tr>
<th>Student fees change</th>
<th>Government or SARS or fiscus (R)</th>
<th>Universities (R)</th>
<th>Students (R)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Additional claim or (refund) of VAT incurred on mixed expenses</td>
<td>(7.5 million)</td>
<td>7.5 million</td>
<td>-</td>
</tr>
<tr>
<td>Output tax received or</td>
<td>61.5 million</td>
<td>(61.5 million)</td>
<td></td>
</tr>
</tbody>
</table>
It is clear that following the above that SARS would be in a better off position if university fees are made taxable. The students would be in a similar position and the universities (which are currently facing immense pressure from students to reduce fees) would be in a worse off position.

A solution to this problem needs to be sought, to place all three parties in preferably the exact same position, but take away the burden of apportionment from universities. The possible solution to this would be a reduced rate, the following example illustrates the point:

**Example (figures are rounded in the example)**

- The supply of educational services is taxable at a reduced rate, instead of the current 14% VAT levied in terms of section 7(1);
- University B receives a yearly government grant of R1 billion;
- University B receives fees of R500 million (including VAT) a year;
- University B incurs VAT on mixed expenses to the amount of R10 million for 2015 and has an apportionment percentage of 25% in 2015.

Continuing from the previous example SARS is in a better off position of R54 million and University B is in a worse off position, the students are in the exact same position whether or not the supply of educational services are made taxable. Therefore, a method needs to be devised to bring back equilibrium to the scenario, where none of the parties are at a loss, or at least such a significant loss.

If the R7.5 million loss SARS makes on the additional input tax deduction, which University B can make on its mixed expenses, is calculated as a percentage of the total VAT levied on fees, the following percentage would be obtained:

\[
\frac{7.5 \text{ million}}{61.5 \text{ million}} = 12.2\%
\]

Therefore, a reduced rate would then be calculated as follows:
12.2% \times 14\% = 1.7\% \text{ (reduced rate, i.e. the VAT percentage would be 1.7\% instead of 14\%)}

This will result in the split between University B’s fees and the VAT levied as follows:

\[
500 \text{ million} / 101.7 \times 100 = R492.5 \text{ million (this would be the universities fees excluding VAT)}
\]

\[
492.5 \text{ million} \times 1.017 = R500 \text{ million (therefore the total cost for the students would remain R500 million for the year, i.e. no additional costs to the students and no apportionment calculation for the universities)}
\]

SARS would collect an amount as additional output tax and the universities would lose this amount in fees:

\[
500 \text{ million} - 492.5 \text{ million} = R7.5 \text{ million}
\]

The net position is the supply of educational services is made taxable at a reduced rate for the three parties involved in the example (government or SARS or fiscus, universities, students) can be set out in the following table:

<table>
<thead>
<tr>
<th></th>
<th>Government or SARS or fiscus (R)</th>
<th>Universities (R)</th>
<th>Students (R)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Student fees change</strong></td>
<td></td>
<td></td>
<td>-</td>
</tr>
<tr>
<td>Additional claim or (refund) of VAT incurred on mixed expenses</td>
<td>(7.5 million)</td>
<td>7.5 million</td>
<td></td>
</tr>
<tr>
<td><strong>Output tax received or (paid) on VAT levied on fees</strong></td>
<td>7.5 million</td>
<td>(7.5 million)</td>
<td></td>
</tr>
<tr>
<td><strong>Net position</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>
A perfect outcome it would be seem, as all parties involved are in a similar position, plus the added benefit of removing the burden of apportionment from universities. Unfortunately, there are stumbling blocks which first need to be overcome before this option could be applied practically.

For example the reduced rate would not be the same for all universities. The one clear reason is the fact that the research intensive universities will have a larger amount of VAT incurred on mixed expenses that it would be allowed to recover when the supply of educational services are made taxable. Following from the examples this will result in a higher reduced rate than universities with minimal research activities.

If the reduced rate is set too high, it would mean that less research intensive universities, would lose out on fees and not gain a similar amount in an additional VAT incurred claim as it did not have extensive mixed expenses in the first place. This would lead to the less research intensive universities being disadvantaged once more.

Even though the burden of apportionment in terms of section 17(1) would be removed from universities, this option could lead to a reduced rate that needing to be calculated on a yearly basis. The reason being, the business models of universities are constantly changing, and it would be short sighted to believe that the same reduced rate would continuously have the required result. For instance universities which receive less research funding in a year would want a lower reduced rate and SARS would want the opposite in a reverse situation. (Value-Added Tax Act, No. 89 of 1991, 1991:s17)

At this stage it would be best to continue with what seems to be the lessor of two evils, if the current section 17(1) apportion position is weighed up against the possibility of a reduced rate, unless a way is found in which to easily calculate a reduced rate that somehow takes each university’s individual needs into consideration and produces the required result for all three parties involved. This is unfortunately highly improbable as the universities in South Africa find themselves on different ends of the spectrum in terms of so many important aspects, for instance funding to name but one. (Value-Added Tax Act, No. 89 of 1991, 1991:s17)

It is therefore difficult to envision any formula, be it an apportionment formula or a reduced rate formula, which could possibly accommodate all the universities. Therefore, once more, a simpler solution needs to be found.
5.2.2. Zero-rate the supply of educational services

Similar to the aforementioned discussion of a reduced rate, this possible solution also considers the supply of educational services to be taxable. Specifically taxable at a rate of 0% in terms of section 11. Section 11 already makes provision for VAT on certain supplies to be levied at 0%. (Value-Added Tax Act, No. 89 of 1991, 1991:s11)

The most important difference to consider between that of a supply made at 0% in terms of section 11 and an exempt supply in terms of section 12, is the fact that supplies made at 0% are still taxable supplies in terms of the VAT Act. Therefore, VAT incurred on expenses incurred in the making of zero-rated supplies will still be claimable by the vendor, as opposed to the VAT incurred on expenses relating to the making of exempt supplies not being claimable by the vendor. (Value-Added Tax Act, No. 89 of 1991, 1991:s11) This concept is illustrated in the following example:

Example (figures are rounded in the example)

- The supply of educational services is taxable at a rate of 0%;
- University B receives fees of R500 million (excluding VAT) a year;
- University B incurs VAT on mixed expenses to the amount of R10 million for 2015 and has an apportionment percentage of 25% in 2015.

The student fees will remain the same if VAT is levied at a rate of 0%:

500 million x 1.00 = R500 million (therefore the total cost for the students would remain R500 million for the year, i.e. no additional costs to the students and no apportionment calculation for the universities, SARS would also not collect any additional tax)

In terms of the additional input tax deduction on mixed expenses SARS would be at a loss and the universities would be at a gain, as follows:

10 million x 25% = R2.5 million (University B previously would only have been allowed to claim this amount of VAT incurred on mixed expenses)
Now University B will be allowed to claim the full R10 million VAT incurred as it does not make any exempt supplies, i.e. all its expenses are incurred in the making of taxable supplies, as follows:

10 million – 2.5 million = R7.5 million (SARS would be at a loss if section 12(h)’s scope is reduced to exclude universities)

The net position if the supply of educational services would be made taxable at 0% for the three parties involved in the example (government or SARS or fiscus, universities, students) can be set out in the following table:

<table>
<thead>
<tr>
<th></th>
<th>Government or SARS or fiscus (R)</th>
<th>Universities (R)</th>
<th>Students (R)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Student fees change</td>
<td></td>
<td></td>
<td>-</td>
</tr>
<tr>
<td>Additional claim or (refund) of VAT incurred on mixed expenses</td>
<td>(7.5 million)</td>
<td>7.5 million</td>
<td></td>
</tr>
<tr>
<td>Output tax received or (paid) on VAT levied on fees</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Net position</td>
<td>(7.5 million)</td>
<td>7.5 million</td>
<td>-</td>
</tr>
</tbody>
</table>

This example provides a rare scenario where SARS is in a loss position. In usual circumstances such a result will immediately end the possibility of such an option, which is understandable. SARS’ main purpose is to collect taxes on behalf of government, and government will usually only make a concession in terms of legislature if there is a need for it in a specific sector for instance.

In light of the aforementioned South Africa finds itself on the precipice of change in the higher education sector. October 2015 marked the start of violent protests of students against the increase of fees for 2016. This has been met with the president coming out and
saying that no fees will be increased in 2016, thereby implying that the necessary funding would be found somewhere else. Unfortunately the required funding for such a statement amounts to billions of Rands and is unlikely to come from one source.

As stated earlier, one of the options the government usually considers when support is needed in a sector is a reduction of taxes, or some other form of concession which alleviates the tax burden. It is by mere coincidence that the student protests against higher fees coincides with US making submissions to the Davis Tax Committee on possible ways of lessoning the burden of apportionment on universities. In considering the discussion thus far and the examples provided it would be the perfect opportunity for government, to not only address the issue universities currently have in terms of its apportionment methodology, but provide an avenue of funding for the universities, which are not allowed to increase fees for 2016. Government will undoubtedly have to find other sources of funding as well, but the current apportionment methodology situation has come about in the timeliest of fashions.

Should government amend the legislation to zero-rate the supply of educational services by universities in terms of section 11, the discussion would have gone full circle, as the first submission in this regard was made on 12 September 1991 in which the VATCOM had to consider whether all educational services should be zero-rated and decided against it. (Value-Added Tax Act, No. 89 of 1991, 1991:s11) (Department of Finance, 1991:1)

5.3. Latest developments

As the purpose of the apportionment methodology is supposed to be an interim measure, until the universities implement processes to code its income streams from taxable and exempt funding correctly, the VCRs also provide insight into where in the process SARS is in terms of gathering sufficient information regarding the most appropriate methodology. The correct coding of the aforementioned would allow for the application of the turnover-based method by universities. Therefore, the original VCR only provided that the ruling applied from 1 April 2012 until 31 December 2012. As a result of the uncertainty in the sector on the most effective method to apply and the difficulty in coding the income streams, the ruling has been extended as mentioned earlier until 31 December 2015.
The VCRs continue by setting out specific arrangements and conditions for the universities to adhere to, which provides an indication of what SARS perceives to be a fair and reasonable method which should apply to universities, as well as the elements which require further investigation:

- The initial VCR issued on 1 August 2012 specifically states that it only applies for a limited period so as to allow universities sufficient time to correctly code the various income streams (as many universities do not differentiate between zero rated and exempt funding which does not allow for the attribution of income, i.e. this prevents the application of the turnover-based method) so that other apportionment methods can be considered. SARS states in the latest VCR (dated 12 March 2015) that the previous VCR (dated 20 February 2013), which expired on 31 December 2014, is extended to allow universities sufficient time to correctly code the various income streams so that alternative apportionment methodologies can be considered in order to determine the appropriateness of the current dispensation. As a result, the universities, as agreed to with US, had to present SARS with a calculation of an apportionment ratio using the turnover-based method of apportionment for the 2013 tax year together with details of the various income streams which form the basis of this calculation on 31 March 2015.

- The latest VCR (dated 12 March 2015) states that universities must provide SARS with a list containing the high value capital assets (purchase price exceeding R1 million), the cost of acquisition and the number of hours the asset is applied to contract or applied research projects in comparison to education and basic research projects. It is important to reiterate at this point that the VCRs do not apply to the capital assets (with a purchase price of more than R1 million) which a university purchases for research purposes. One of the main reasons for SARS requesting this information is the fact that these capital goods are excluded from the VCRs as well as the formula which calculates the percentage. Therefore, as it currently stands, the non-capital expenses’ are used to calculate the percentage which is applied to the capital goods (purchase price less than R1 million) used for mixed purposes. However, this percentage might not be a true reflection of the proportion of taxable use of the capital goods, as the capital goods acquired for research purposes are not used in determining the percentage. Currently, the VCRs provide that a separate ruling application is required for capital assets purchased for research purposes which are used for mixed purposes of which the purchase price exceed R1 million or if the percentage in terms of the table of the VCRs are not appropriate. The inclusion
of this paragraph in the VCRs is a clear indication that there is still much uncertainty surrounding the current apportionment methodology and whether or not the varied input method is the most appropriate in the higher education sector. Practically the aforementioned issue can be illustrated by the following example: A capital asset (purchase price less than R1 million) purchased and used for internally funded research performed by a university’s engineering department is most likely to be used in applied research. Therefore, applying the table as per the VCRs the input tax claim of the university will be limited to 50% on the VAT incurred in purchasing that specific asset. However, when the ratio of the number of hours the asset is applied to contract or applied research projects in comparison to education and basic research projects is determined, it might be far different than the 50:50 ratio allowed by the said table. If the capital goods acquired for research purposes are included in the formula (as the non-capital research expenses are included), the percentage will reflect to a certain degree (i.e. the weight of the VAT incurred in acquiring the asset in relation to all the other VAT incurred included in the formula) the taxable use of the asset. Currently, this is not the case as the non-capital expenses are used to determine the percentage applied to the capital goods (purchase price less than R1 million) and that is why SARS requires this information to analyze whether or not the current varied input-based method provides a fair and reasonable result or whether a separate method should be considered for capital goods used in research activities. Practically, the majority of universities are currently not applying for separate special apportionment methods for capital assets acquired for research purposes with a purchase price of more than R1 million or capital assets for which the percentages per the table are not appropriate, as this is a too arduous task and instead applies the percentages as provided for by the table to capital assets acquired for research purposes with a purchase price exceeding R1 million as well.

- The VCRs state in relation to the application of the ruling, that universities are using an estimated ratio from 1 April 2012 to 31 December 2012, and therefore are required to make the relevant adjustment to the apportionment calculation of general overheads within 3 months\(^49\) after year-end by applying the following:

  o The adjustment applicable to the period 1 January to 31 March 2012 will be calculated by applying the varied input method applied by universities in that period to the actual input tax incurred for the full year from 1 January 2012 to

\(^{49}\) This period has been increased to 6 months in the VCR issued 12 March 2015 with reference “HESA ruling” in line with BGR 16 issued on 30 March 2015.
31 December 2012. The adjustment will equal the difference between the ratio determined for the full year and the 2011/12 ratio applied in the January to March 2012 period.

- The adjustment application to the nine month period from 1 April to 31 December 2012 will be calculated by applying actual input tax incurred to the general overhead formula for the period from 1 April to 31 December 2012. The adjustment will equal the difference between the ratio determined and the ratio applied in the nine month period, limited to 12.5%.

- Similar to the aforementioned the ruling extensions issued with regards to the initial VCR applies for the period 1 January 2013 to 31 December 2015. The latest ruling extension to the VCR states that a vendor who is subject to apportionment may calculate the apportionment ratio using the figures from the previous year’s source documentation, and apply that ratio for purposes of deducting input tax during the current year. An adjustment must be made annually to account for any shortfall or excess in respect of input tax deducted in the previous financial year using the figures from the source documentation for the current financial year. Universities are required to effect the annual adjustment within a period of 6 months after the financial year end.

- Any ruling issued to a university approving a method of apportionment other than that which is provided for in this ruling, is hereby withdrawn. The effective date of withdrawal is 31 March 2012.

As a result of the ongoing investigation by SARS, members of US and professional consulting firms another ruling extension application has been submitted. The ruling extension application of the VCR requests an extension of the use of the varied input-based method until the end of 31 December 2017. Although it seems prudent to take as much time as needed in order to decide on the best possible outcome for all parties involved, it is unlikely that the status quo will remain until 31 December 2017.
5.4. Conclusion

This chapter concluded that the current investigation of apportionment methodology applied in the higher education sector (which has been undertaken by government, members of US and professional consulting firms) needs to be concluded as soon as possible and a clear practical and sustainable approach needs to be agreed upon, as it is in the best interest of all of the parties involved as well as South Africa and the education of its people as a whole.
6. Conclusion

Section 17(1) of the VAT Act requires the apportionment of VAT incurred on mixed expenses. The only method of apportionment allowed by SARS without having to apply for a ruling from SARS is the turnover-based method. (Value-Added Tax Act, No. 89 of 1991, 1991:s17)

It is confirmed that for any method to be effective in calculating the percentages of universities on a yearly basis, it is fundamental that the method adheres to the following principles: ‘direct attribution’, ‘consistency’ and ‘fair and reasonable’. Furthermore, it is established that although the turnover-based method adheres to these principles, it is not the most effective and appropriate method for every sector in South Africa, for various reasons and other methods need to be considered.

After application to SARS by US for a different method, SARS approved the use of the varied input-based method of apportionment for universities. However, it is concluded that the varied input-based method is definitely not the long term solution as the difficulty in its application and the financial burden makes it impracticable to use. As all possible apportionment solutions seem to result in varying degrees of difficulty or outcomes not adhering to the principles of apportionment, other possible solutions, outside of apportionment, are considered.

Other possible solutions in general considered the possibility of amending section 12(h) to exclude universities, thereby making the supply of educational services by universities taxable. A further possible solution is considered, which is to zero-rate the supply of educational services by universities in terms of section 11. This would not only alleviate the burden of apportionment, but also result universities being allowed to claim all the VAT it incurs (except for input tax denied in terms of section 17(2)) and result in a net gain for the universities. (Value-Added Tax Act, No. 89 of 1991, 1991:s1, 1991:s12, 1991:s17)

Whether government will consider this a viable option or not, it is concluded that a clear practical and sustainable approach needs to be agreed upon, as it is in the best interest of all of the parties involved, as well as South Africa and the education of its people as a whole.
Appendix A

Value-Added Tax Act No. 89 of 1991

Section 1 – Definitions

(1) “input tax”, in relation to a vendor, means -

(a) tax charged under section 7 and payable in terms of that section by -

(i) a supplier on the supply of goods or services made by that supplier to the vendor; or

(ii) the vendor on the importation of goods by that vendor; or

(iii) the vendor under the provisions of section 7(3);

(b) an amount equal to the tax fraction (being the tax fraction applicable at the time the supply is deemed to have taken place) of the lesser of any consideration in money given by the vendor for or the open market value of the supply (not being a taxable supply) to him by way of a sale on or after the commencement date by a resident of the Republic (other than a person or diplomatic or consular mission of a foreign country established in the Republic that was granted relief, by way of a refund of tax as contemplated in section 68) of any second-hand goods situated in the Republic;

(c) an amount equal to the tax fraction of the consideration in money deemed by section 10(16) to be for the supply (not being a taxable supply) by a debtor to the vendor of goods repossessed under an instalment credit agreement or a surrender of goods: Provided that the tax fraction applicable under this paragraph shall be the tax fraction applicable at the time of supply of the goods to the debtor under such agreement as contemplated in section 9(3)(c),

where the goods or services concerned are acquired by the vendor wholly for the purpose of consumption, use or supply in the course of making taxable supplies or,

where the goods or services are acquired by the vendor partly for such purpose, to the extent (as determined in accordance with the provisions of section 17) that the goods or services concerned are acquired by the vendor for such purpose;
Section 12 – Exempt supplies

(h) the supply of educational services-

(aa) provided by the State or a school registered under the South African Schools Act, 1996 (Act No. 84 of 1996), or a public college or private college established, declared or registered as such under the Further Education and Training Colleges Act, 2006 (Act No. 16 of 2006).

(bb) by an institution that provides higher education on a full time, part-time or distance basis and which is established or deemed to be established as a public higher education institution under the Higher Education Act, 1997 (Act No. 101 of 1997), or is declared as a public higher education institution under that Act, or is registered or conditionally registered as a private higher education institution under that Act; or

(cc) by any public benefit organisation as contemplated in paragraph (a) of the definition of ‘public benefit organisation’ contained in section 30(1) of the Income Tax Act that has been approved by the Commissioner in terms of section 30(3) of that Act and which has been formed for-

(A) adult basic education and training including literacy and numeracy education, registered under the Adult Basic Education and Training Act, 2000 (Act No. 52 of 2000), vocational training or technical education;

(B) the education and training of religious or social workers;

(C) training or education of persons with a permanent physical or mental impairment;

(D) ...........

(E) provision of bridging courses to enable indigent persons to enter a higher education institution as envisaged in subparagraph (bb);

(ii) the supply by a school, university, technikon or college solely or mainly for the benefit of its learners or students of goods or services (including domestic goods
and services) necessary for and subordinate and incidental to the supply of services referred to in subparagraph (i) of this paragraph, if such goods or services are supplied for a consideration in the form of school fees, tuition fees or payment for board and lodging; or

(iii) the supply of services to learners or students or intended learners or students by the joint Matriculation Board referred to in section 15 of the Universities Act, 1955 (Act No. 61 of 1955):

Provided that vocational or technical training provided by an employer to his employees and employees of an employer who is a connected person in relation to that employer does not constitute the supply of an educational service for the purposes of this paragraph.

Section 17 - Permissible deductions in respect of input tax

(1) Where goods or services are acquired or imported by a vendor partly for consumption, use or supply (hereinafter referred to as the intended use) in the course of making taxable supplies and partly for another intended use, the extent to which any tax which has become payable in respect of the supply to the vendor or the importation by the vendor, as the case may be, of such goods or services or in respect of such goods under section 7(3) or any amount determined in accordance with paragraph (b) or (c) of the definition of “input tax” in section 1, is input tax, shall be an amount which bears to the full amount of such tax or amount, as the case may be, the same ratio (as determined by the Commissioner in accordance with a ruling as contemplated in Chapter 7 of the Tax Administration Act or section 41B) as the intended use of such goods or services in the course of making taxable supplies bears to the total intended use of such goods or services: Provided that -

(i) where the intended use of goods or services in the course of making taxable supplies is equal to not less than 95 percent of the total intended use of such goods or services, the goods or services concerned may for the purposes of this Act be regarded as having been acquired wholly for the purpose of making taxable supplies;

(ii) where goods or services are deemed by section 9(3)(b) to be successively supplied, the extent to which the tax relating to any payment referred to in that section is input tax may be estimated where the calculation cannot be made
accurately until the completion of the supply of the goods or services, and in such case such estimate shall be adjusted on completion of the supply, any amount of input tax which has been overestimated being accounted for as output tax in the tax period during which the completion occurs and any amount of input tax which has been underestimated being accounted for as input tax in that period; and

(iii) where a method for determining the ratio referred to in this subsection has been approved by the Commissioner, that method may only be changed with effect from a future tax period, or from such other date as the Commissioner may consider equitable and such other date must fall-

(aa) in the case of a vendor who is a taxpayer as defined in section 1 of the Income Tax Act, within the year of assessment as defined in that Act; or

(bb) in the case of a vendor who is not a taxpayer as defined in section 1 of the Income Tax Act, within the period of twelve months ending on the last day of February, or if such vendor draws up annual financial statements in respect of a year ending other than on the last day of February, within that year,

during which the application for the aforementioned method was made by the vendor.
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