Is the Vale-Added-Tax treatment for educational services still valid?

Is zero-rating a better alternative to the current VAT treatment?

Are there any other alternative VAT treatments available?

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Declaration

I, Diara Jugdhaw, hereby declare that the work on which this thesis is based is my original work (except where acknowledgements indicate otherwise) and that neither the whole work nor any part of it has been, is being, or is to be submitted for another degree in this or any other university. I authorise the University to reproduce for the purpose of research either the whole or any portion of the contents in any manner whatsoever.

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Abstract

The aim of this dissertation is to analyse whether the current VAT treatment for educational institutions is still valid given the development within these institutions and if not, to identify alternative VAT treatments that may be used.

Educational services are an exempt supply under section 12(h) of the VAT Act. The main reason for the exemption of educational services is that many of the institutions providing educational services were government institutions and to some extent financed by the government. However, over the years, the activities of institutions providing educational services have changed drastically and a reduced number of institutes are wholly subsidized in terms of government subsidies. In order to aid government grants and increase income, these institutions have increased their taxable activities considerably. Furthermore, privately owned and semi-subsidized institutions are accountable for their own costs and are not provided any or limited support from government.

Numerous educational institutions within South Africa conduct an enterprise with the rendering of taxable supplies in addition to the provision of educational services. Such additional activities, provided the educational institute qualifies for and is VAT registered, are taxed at the standard rate. This in turn has created complications in administering the VAT Act, whereby these service providers are then required to carry out an apportionment calculation of VAT on their mixed supplies. This practice is inefficient and not cost effective. Furthermore, the ease of compliance, which was the basis in implementing the exemption, is diminished, as registration for VAT purposes is unavoidable.

Educational institutions that render taxable supplies would be incurring inputs on associated costs. The effect of exempting educational services from the VAT net ultimately results in an increase in tuition fees as the burden of “hidden” or “trapped” cost is passed onto the student, as a result of the institution’s inability to claim a refund of the tax paid. As there is no recovery of input tax embedded in the price of exempt supplies, the cost of the tax included in the price must be borne by the entity that acquires the exempt supply and can only be recovered if the tax is passed on to customers. This is in effect contradictory to the initial intention of the government’s political and economic objective in respect of education, to ensure access to education to all on a non-discriminatory basis.

As the objective and intention of the legislation towards exempting educational services is no longer satisfied, it must be reassessed and the treatment relating thereto re-examined. The first alternate VAT treatment recommended is for educational services to be zero rated, this will reduce the administrative burden most educational institutions currently face in terms of carrying out complex apportionment calculations and will keep with the original intention of the VATCOM. Furthermore educational institutions will have additional funding via the release of input tax credits which may potentially result in a reduction in the

percentage increase in student fees in future periods the burden of the ‘hidden’ or ‘trapped cost’ will not be passed onto the student.

Other VAT treatments recommended should zero-rating fail is to tax educational services at a reduced rate or include educational services as a welfare organization activity. Should the above-recommended VAT treatments not be feasible it is suggested that the current VAT treatment be improved by providing additional guidance on what supplies can be included as educational services.

List of abbreviations, Glossary of terms

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

SARS- South African Revenue Service

TAA- Tax Administration Act No. 28 of 2011

VAT- Value-Added Tax

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

VCR- Value-Added Tax Class Ruling

VATCOM- Value-Added Tax Committee

HESA- Higher Education South Africa

GST- Goods and Services Tax

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1. Introduction

1.1. Background

When Value-Added Tax (VAT) was first introduced in 1991, the Value-Added Tax Committee (VATCOM)[1], appointed by the Minister of Finance, recommended at the time that the supply of educational services should be exempt from VAT, similar to the previous sales tax treatment (PricewaterhouseCoopers, 2015).

The reason for exempting educational services was because many of the educational institutions providing these services were funded by government subsidies, therefore any increase in costs for these institutions would be financed by increased contributions by government and there would be no net gain to the government if it were subject to tax. It would merely amount to an increased administrative burden for these institutes (Value-Added-Tax Committee, 1991:22).

However, over the years, the activities of educational institutions providing educational services have changed drastically and a reduced number of educational institutes are wholly subsidised in terms of government subsidies (Alderman & Del Ninno, 1999). In order to aid government subsidies and grants and increase income, these educational institutions have increased their taxable activities considerably. Some of the income streams generated from these taxable activities include the income from residences, research funding and grants, investments and income from the supply of goods and services not related to educational activities. Furthermore, privately owned and semi-subsidised educational institutions are accountable for their own costs and are not provided any or limited support from government.

From a VAT perspective, and with the development of various commercial research projects, and other income streams, most of the established educational institutions are now registered for VAT. As a result, educational institutions provide exempt and taxable supplies, which create complexities in administering the VAT Act. These complexities include carrying out apportionment calculations to account for mixed supplies. This practice is inefficient and not cost effective. Furthermore, the ease of compliance, which was the basis in implementing the exemption, is diminished, as registration for VAT purposes is unavoidable.

The Higher Education South Africa ("HESA") has been involved in ongoing discussions with the South Africa Revenue Service concerning the finalisation of a

[1] Following the issuing of the Draft VAT Bill for general comment on 18 June 1990, the Minister of Finance concurrently appointed a committee namely, the VATCOM consisting of members from both the public and private sectors to deliberate the comments and arguments made by interested parties in respect of the Draft VAT Bill.

VAT class ruling which applies to members of HESA in an attempt to resolve some of the industry challenges faced by educational institutions (Jezznitz, 2012:36).

SARS issued a Draft Binding Class Ruling on 20 January 2012 and a VAT Class Ruling ("VCR") on 1 August 2012. The VCR applies to HESA members and prescribes the apportionment method to be used to calculate the VAT to be allowed as input tax incurred for mixed supply purposes (Jezznitz, 2012:36). However, managing VAT compliance in the sector and designating funds and expenses correctly for VAT purposes remains an area of concern for all educational institutions (PricewaterhouseCoopers, 2015).

The aim of this dissertation is to analyse whether the current VAT treatment for educational institutions is still valid given the development within these institutions and if not, to identify alternative VAT treatments that may be used.

1.2. Research Question

The VATCOM's decision to exempt educational services in 1991 was motivated by the importance of education in South Africa, and the fact that the cost of providing these services to a greater extent would be financed by the State. To this extent, it was stated that:

"[a]ny increase in the costs of these educational institutions will be financed by increased contributions by the State and there will be no net gain to the State if they are subject to tax. It will in the main merely increase the administrative burden of these educational institutions" (Value-Added-Tax Committee, 1991:22).

However, educational institutions have evolved to provide more than just education to their students; they are now often involved in commercial research projects and other business activities such as the sale of goods from campus shops, restaurants, vending machines, admission to plays, concerts, dances and museums etc. They may also provide short-term courses to non-students/the general public, all of which are likely to be subject to VAT (PricewaterhouseCoopers, 2016).

The research question is therefore whether the current VAT treatment of educational services is valid? And if not, whether zero-rating educational services is a better alternative? Or whether other alternative VAT treatments exist?

1.3. Research Method

A doctrinal research methodology is used to compile the research. A review will be undertaken of the relevant provisions of the various Acts, writings of experts in the field, publications by the South African Revenue Service, South African and international textbooks, policies, guidelines, legislation and case law as well as international government reports issued relating directly to the objective of this research.

1.4. Scope and limitations

This research will not explore the apportionment ratio in full; however, it will be examined in certain areas. Loss to the fiscus which may occur if the method of charging VAT on educational activities is changed will not be considered in this dissertation. However, it is acknowledged that this will be a factor to consider if any change is to be made to the way educational institutions are taxed in terms of the VAT Act.

1.5. Structure

Chapter 2 – Is the current VAT treatment of educational services valid?

Chapter two will evaluate the design of the current VAT treatment of educational services in South Africa. This will look at the reasons for exempting educational services in South Africa as well as explore how the activities of educational institutions have evolved over the years. Further, a review of the current mechanisms in place to alleviate some of the VAT burden in South Africa will be performed. This will include a review of the reasonability and appropriateness of the class ruling issued by SARS to HESA regarding the agreed alternative method of VAT apportionment to be applied by the applicants to such request.

In addition, the study will analyse the challenges faced by educational institutions with the current VAT treatment as well as look at the disadvantages of exempting educational services. A conclusion will then be made on whether the current VAT treatment of educational services is still valid.

Chapter 3- Is zero rating educational services a better alternative?

Chapter three will analyse whether zero-rating educational services is a better alternative to be used. The analysis will be performed by examining the criteria for zero-rating certain goods and services in South Africa and determine whether educational services meet these criteria. Further, an analysis of the Australian tax

treatment of educational services will be analysed, as the South African VAT Act is similar to Australia's Goods and Services Tax (GST).

Chapter 4 – Are there any other alternative VAT treatments that can be used?

Chapter four will recommend alternative VAT treatments that exist to tax educational services; this will include examining taxing educational services at a reduced rate as well as including educational institutions as welfare organizations. The New Zealand treatment of education is also analysed as the South African VAT Act mirrors New Zealand's GST regulations in many ways. Furthermore, the impact the current VAT treatment has on private educational institutions will be discussed. Lastly, recommendations to the current VAT treatment are provided should the alternative VAT treatments suggested not be feasible.

Chapter 5 – Conclusion

2. Is the current VAT treatment of educational services valid?

This chapter will evaluate the design of the current VAT treatment of educational services in South Africa. It will review the reasons for exempting educational services in South Africa as well as explore how the activities of educational institutions have evolved over the years. Further, a review of the current mechanisms in place to alleviate some of the VAT burden in South Africa will be performed. This will include a review of the reasonability and appropriateness of the class ruling issued by SARS to HESA regarding the agreed alternative method of VAT apportionment to be applied by the applicants to such request.

In addition, the chapter will analyse the challenges faced by educational institutions with the current VAT treatment as well as look at the disadvantages of exempting educational services. A conclusion will then be made on whether the current VAT treatment of educational services is still valid.

2.1. Reasons for exempting educational services

In order to analyse the current VAT treatment of educational institutions it is important to understand the background and intention of the legislator at the time of implementing the legislation and more importantly what the legislation was meant to achieve.

The 1991 Draft VAT Bill provided that educational services provided by primary, secondary and tertiary educational institutions, the state and certain permanent institutes approved by the Minister of Finance would be exempt[2] from VAT (Value-Added-Tax Committee, 1991:22) .

The reason for this proposal was because many of the educational institutes providing these services were to a greater or lesser extent financed by the State. Any increase in the costs of these institutions would be financed by increased contribution by the State and therefore there would be no net gain to the State if it were subject to tax. There would merely be an increase in the administrative burden for these institutions as more than 21 000 educational institutions in South Africa would be required to account for and submit VAT returns if VAT was imposed on them. This would have increased the administrative costs of institutions, which are not geared to comply with taxation laws,

[2] In terms of section 1 (1) definition of “enterprise” proviso (v) of the VAT Act, if a person makes only exempt supplies then they are deemed to be not conducting an enterprise and would therefore not be able to register as vendors for VAT purposes. If supplies are zero-rated, this does not apply and suppliers would register as vendors. If a combination of exempt and taxable supplies are made an apportionment of inputs has to be made, as input VAT related to making exempt supplies is not permitted as a deduction. This is discussed in chapter 2.

and in addition, there would be no gain to the fiscus (Value-Added-Tax Committee, 1991:22-23).

The importance of education in South Africa was a further motivation for exempting educational services. It was argued that educational institutions within South Africa provide a vital service to the country and no additional burden should be placed on students who receive any educational service listed in section 12 (h) of the VAT Act (Value-Added-Tax Committee, 1991:23).

Several representations were received at the time of this proposal, some of which included oppositions to the proposal of exempting these services from VAT as well as zero-rating the educational services instead of exempting it (Value-Added-Tax Committee, 1991:23).

The opposition to the proposal that educational services be exempt from VAT was motivated by the desire to keep exemptions and exceptions to the rule to a minimum, to ensure a wide tax base and to keep the VAT system simple. While VATCOM shared these goals, they were of the opinion that because educational institutions played such a crucial role in South Africa and taxation thereof would not result in any revenue to the fiscus, this was a special case. There was merit in treating educational institutions on the same basis as public authorities that were funded by the State and provided services to the public (Value-Added-Tax Committee, 1991:23).

Zero rating of all educational institutions was also considered, however VATCOM was of the view that this would have little to no effect on the fiscus of the country as the majority of the educational institutions received funding or assistance from the State. Furthermore, the committee was in favour of the exemption as it would significantly alleviate the institutions administrative burden and would not require the institution to register for VAT (Value-Added-Tax Committee, 1991:23).

Pre-primary educational centres requested the zero rating, as they were not primarily funded by way of government subsidies however, VATCOM declined this request stating:

"While the VATCOM acknowledges the important service provided by these centres, in keeping with the basic philosophy that assistance to deserving causes should be provided outside the tax system, it cannot support zero-rating for these services" (Value-Added-Tax Committee, 1991:23)

There was also concern that private and commercial schools would be excluded from the exemption because of the wording "of a public character" in the exemption. However, the wording was made to imply the inclusion of the public and private sector and hence private and commercial schools would qualify for the exemption. Similar to

pre-primary education this originally was to ensure that all schools received the same standardised treatment (Deloitte, 2015).

While taxing educational institutions was viewed as merely increasing the administrative burden on such institutions this did not prevent these institutions from registering. Educational institutions receiving income from sources other than education still had to register for VAT. This not only resulted in VAT registration liability but also created complex apportionment ratio problems. As such, the administrative burden was not reduced but substantially increased in many cases (Deloitte, 2015).

2.2. Developments in educational institutions (specifically higher education institutions) in South Africa

Over the last few years, Higher Education Sectors throughout the world have been exposed to various transformatory forces. Steyn states that "*these transformatory sources are largely brought about by the processes of globalisation and the increasing dominance of neoliberal discourse*" (Steyn, 2005). The process of democratisation in South Africa as well as government's commitment to reconstruction of the countries social and economic development has also had an impact on these forces (Kraak, A: 2000).

The entire education sector in South Africa has advanced in terms of achieving national goals of quality, equity and transformation. Higher educational institutions have made great developments over the years; some of these developments include (Council on Higher Education, 2016: 9):

- integration as a system from its fragmented past;
- improved quality education provided
- greater access and a major changes in the demography of its students, with an 80% growth in the number of African students;
- higher research output and international recognition through large research projects

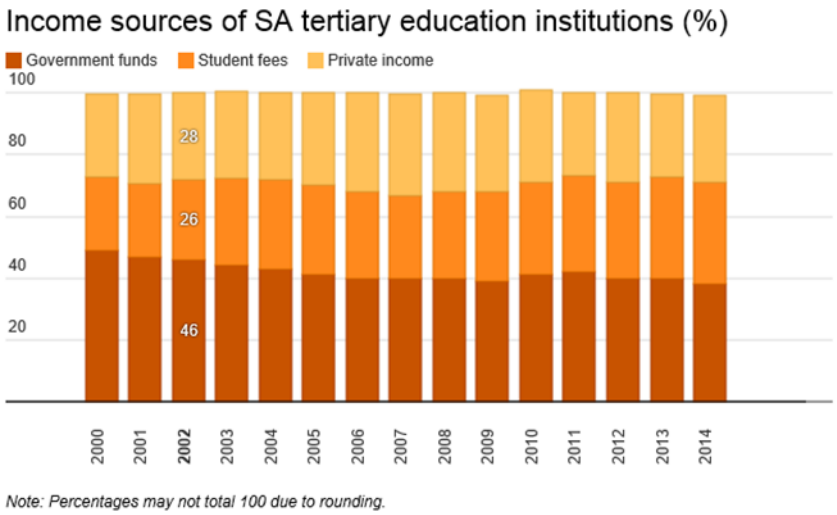
To further these developments within the higher education system, various new funding drivers had to be introduced. These funding drivers include student fees, third stream income and state funding in the form of government subsidies. However, this three-stream model of funding is seriously skewed in South Africa today (Bozolli, 2015)

The key problem faced by educational institutions is that the subsidies and grants provided by government is extremely low in absolute terms. Bizolli states, "*South African university funding languishes at levels below those of dozens of emerging economies at a mere 0.6% of GDP. Furthermore, South Africa's expenditure on Higher Education is a*

mere 12% of expenditure on education as a whole, whereas for the rest of Africa it is 20%, for OECD countries it is 23.4%, and for the rest of the world it is 19.8% "(Bozolli, 2015).

To make it worse, government subsidies and grants for higher educational institutions has been declining in real terms over the years while student numbers have risen dramatically (Bozolli, 2015).

According to the data from the Centre for Higher Education Trust, the contribution government makes to higher educational institutions and public universities income has declined from 49% in 2000 to 38% in 2014 (Makou,Wilkinson & Bhardwaj: 2016).



At the same time, the government has forced higher educational institutions extremely hard on a number of fronts (Bozolli, 2015):

- Government has more than doubled the amount of students enrolled in higher educational institutions within twenty years.
- Many of the students who form part of the increase in number of students come from underprivileged backgrounds and are unable to fund their tertiary education. This has put a lot of pressure on the National Student Financial Aid Scheme (NSFAS).
- The way in which government allocates funds to higher educational institution in their time of financial scarcity has resulted in higher educational institutions becoming more factory like and unattractive to the best academic staff.
- The funding provided by government is not sufficient to cover infrastructure development or proper maintenance for higher educational institutions. The result of this is a decline and decay of buildings, a datedness to key teaching and research infrastructure, and a lowering of morale.

- One of government's objectives is to increase the research output of higher educational institutions as well as the number of postgraduate students but has not properly funded these programmes.

Higher educational institutions have tried to deal with these pressures in a situation of falling income by increasing class sizes to unacceptable levels to save on employing more staff, putting up student fees, and raising third stream income (Bozolli, 2015).

In response to the dire shortages of funding, most higher educational institutions have successfully elevated their levels of third stream income. The third stream income is earned from housing residences, research funding and grants, investments and income from the supply of goods and services not related to educational activities such as parking and gym facilities. From a VAT perspective, and with the emergence of various third stream income, most of the established educational institutions are now registered for VAT as they are making exempt and taxable supplies. Educational institutions now face extreme challenges in managing their VAT risk in a very complex environment.

2.3. Current VAT treatment

Educational services supplied in terms of s12(h) of the Value-Added-Tax Act are exempt from the tax imposed under s7(1)(a) of the VAT Act.

Section 7(1) (a) of the VAT Act provides that where a vendor supplies goods or services in the course or furtherance of any enterprise carried on by him, such goods or services will be subject to VAT at the standard rate of 14% provided that certain exemptions, exceptions, deductions and adjustments are not applicable (Value-Added Tax Act No. 89 of 1991, 1991: s7).

The supply of educational services by the following entities is exempt from VAT in terms of s12 (h) of the VAT Act (Value-Added Tax Act No. 89 of 1991, 1991: s12):

- by the State or a school registered under the **South African Schools Act, 1996 (Act No. 84 of 1996)**
- by 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)**
- 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

- by any public benefit organisation as contemplated in paragraph (a) of the definition of a '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—
    - 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;
    - education and training of religious or social workers;
    - training or education of persons with a permanent physical or mental impairment;
    - provision of bridging courses to enable indigent persons to enter a higher education institution as envisaged in subparagraph (bb), or
- by the Joint Matriculation Board referred to in section 15 of the Universities Act, 1955 (Act No. 61 of 1955).

The various types or categories of educational services are not specifically defined in the VAT Act but in each instance is defined in terms of a specific Act. A vast array of educational institutions may qualify as supplying education as envisaged in the VAT Act. These Acts are examined further below (Deloitte, 2015):

South African Schools Act, 1996 (Act No. 84 of 1996)

The South African Schools Act defines the term school as follows:

School –*"to mean a public school or an independent school which enrols learners in one or more grades from grade R (Reception) to twelve"*

The Further Education and Training Colleges Act, 2006 (Act No. 16 of 2006) ("FET Act")

The FET Act defines the institutes as follows:

college – *"to mean a public or private further education and training institution that is established, declared or registered under this Act, but does not include –*

a) a school offering further education and training programmes under the South African Schools Act; or

b) a college under the authority of a government department other than the Department."

private college – *"to mean any college that provides further education and training on a full-time, part-time or distance basis and which is registered or provisionally registered as a private college under this Act"*

public college - *"to mean any college that provides further education and training on a full-time, part-time or distance basis and which is –*

a) established or regarded as having been established as a public college under this Act; or declared as a public college under this Act"

Higher Education Act, 1997 (Act No. 101 of 1997)

The Higher Education Act defines the following terms:

Higher education institution – *"to mean any institution that provides higher education on a full-time, part-time or distance basis and which is-*

a) established or deemed to be established as a public higher education institution under this Act;
b) declared as a public higher education institution under this Act; or
c) registered or conditionally registered as a private higher education institution under this Act;"

Private higher education institution – *"to mean any institution registered or conditionally registered as a private higher education institution in terms of Chapter 7"*

Public higher education institution – *"to mean any higher education institution that is established, deemed to be established or declared as a public higher education institution under this Act"*

Technikon – *"to mean any technikon established, deemed to be established or declared as a technikon under this Act"*

University – *"to mean any university established, deemed to be established or declared as a university under this Act"*

As seen above, the various Acts do not appear to specifically define "educational services". However, it is evident from the different educational services addressed by each Act, that the levels of education provided (i.e. primary, secondary and tertiary education) is distinguishable. It is important that consideration should be given to the various operations, associated costs as well as complexity in terms of

each level of education before applying a standardized VAT treatment to all educational institutions (Deloitte, 2015).

Moreover, subsection (ii) to section 12(h) includes:

"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 above if such goods or services are supplied for a consideration in the form of school fees, tuition fees or payment for board and lodging."

Therefore, where additional goods and services are not supplied as part of the consideration for and payment of the tuition fees, school fees or fees or payment for board and lodging, they will fall outside this category and will be subject to VAT (Jessnitz, 2012:35).

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 also does not constitute the supply of an educational service (Value-Added Tax Act No. 89 of 1991, 1991: s12).

As the term educational services is not defined in either the VAT Act or in the various Acts referenced in section 12(h), it remains to argue that educational services can only be termed or defined in terms of what it includes. Thus, while "educational services" have not been specifically defined in the VAT Act, it is nevertheless clear that services, covered by the referenced Acts, is included in the definition. Moreover, in terms of subsection (ii) to section 12(h), reference has been made as to what "educational services" is envisaged to include.

If the taxable supplies of an educational institution exceed R1 million per annum they will be obliged to register for VAT and declare output tax on their taxable supplies. No VAT is charged on exempt supplies made by organizations and they cannot claim input tax credits on their purchases or only a portion is recoverable through the application of an apportionment ratio. The details of the exemption are complex for educational institutions and the mixture of supplies that are rendered by these institutions creates even more difficulties.

2.4. Current apportionment method

Under current legislation universities' tuition fees, accommodation fees and state-funded research are exempt from VAT. However, certain contractual research and other third income streams are taxable supplies and should be standard rated for VAT purposes. Thus, institutions have to calculate an apportionment ratio on an annual basis (PricewaterhouseCoopers, 2015).

In an effort to resolve some of the complexities caused by the apportionment ratio, the South African Revenue Service (SARS) has been involved in an ongoing discussion with the Voice of Higher Education Leadership in South Africa, Higher Education South Africa (HESA), regarding the finalisation of a VAT class ruling applicable to the members of HESA (Jezznitz, 2012:36).

SARS issued a Draft Binding Class Ruling on 20 January 2012 and a VAT Class Ruling ("VCR") was issued on 1 August 2012 until 31 December 2012. This VCR has been extended several times, the latest being 31 December 2015. The VCR applies to public universities and universities of technology in South Africa, which are members of HESA, and prescribes the apportionment method to be used to calculate the VAT to be allowed as input tax incurred for mixed supply purposes (PricewaterhouseCoopers, 2015).

The VCR provides for specific modifications to the input-based method, which are unique to higher educational institutions. Higher educational institutions supplies consist primarily of exempt educational services. However, to obtain funding from other sources, higher educational institutions have expanded their range of services and now apply their resources to supply additional services. One income stream that has become a material source of revenue for the majority of higher educational institutions is research income in its various forms. The VCR specifically addresses research activities and defines 'applied research', 'basic research' and 'research grants' which is defined below. In addition, it outlines the input tax treatment of these specific research types (Jessnitz, 2012:36).

"**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 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.*

The ruling provides that only 'basic research' would not be regarded as a VAT enterprise activity. Where the research is conducted with no student involvement, a full input tax deduction would (in principle) be allowed for applied (contract) research. However, where the 'applied and contract research' requires any form of student involvement, the research is regarded as being a mixed supply and full input tax may not be deducted (Jessnitz, 2012:36).

SARS has also capped the apportionment ratio at 12.5%; this means that only 12.5% of VAT may be deducted in respect of expenses which cannot be directly attributable to taxable, exempt or non-supply income. Therefore, should the apportionment ratio exceed 12.5%, it is limited to 12.5%. However, if the apportionment ratio is calculated to be less than 12.5%, the lesser percentage should be applied. Furthermore, the ruling requires that universities will have to code their zero-rated and exempt funding correctly (Jessnitz, 2012:36).

2.5. Challenges faced by educational institutions specifically higher educational institutions

The rising costs of education and the reduced funding from government has resulted in most educational institutions increasing their activities, which fall outside of the s12 (h) exemption. Consequently, these institutions have to register for VAT and have to apportion the VAT that cannot be wholly attributed to either taxable or exempt supplies. The Majority of these institutions are not equipped to handle these complex apportionment ratio calculations.

The formula proposed in the VCR, as well as previous proposed formulae, is highly complex. In addition, new apportionment ratio calculations often require change in use adjustments that creates additional complexity. The additional costs of implementing this apportionment ratio erodes the funds that should have been used for the further advancement and development of education (Deloitte, 2015).

Furthermore, educational institutions do not have the necessary resources and software required to compute and evaluate such ratios, which in turn increases the risk for error, manipulation and incorrect implementation.

The above demonstrates that the initial intention of the VATCOM, i.e. maintaining the least amount of administrative burden and keeping the VAT system simple in respect of the education sector, is no longer met.

2.5.1. Impact the new e-service legislation has on educational institutions

The majority of students currently make use of digital libraries offered by educational institutions because of advancements in technology, environmental concerns and access to information. Students are able to access extensive amounts of information from electronic databases made available by universities and sourced from foreign suppliers (Van Eeden, 2013).

However, the introduction of VAT on e-service transactions has a knock-on effect on the cost of education, as educational institutions cannot claim the amount back as input tax[3], which creates an additional cost for educational institutions (Van Eeden, 2013).

2.6. Disadvantages in exempting educational services

- An exemption from VAT does not totally absolve the goods or services from the impact of VAT, as the supplier of the goods or services cannot deduct the VAT incurred on goods or services acquired to make the exempt supply, as input tax.
- The administrative and financial functions in respect of educational institutions may be more efficient if outsourced. However, these are normally handled internally due to the VAT leakage, which arises when outsourcing such functions. Outsourcing such functions may allow for more efficient and cost effective operations and, therefore, possibly larger funds available for, e.g. bursaries. In addition, private institutions outsource the majority of their training, incurring VAT inclusive costs. These cannot be claimed which leads to inefficiencies and higher education costs (Deloitte, 2015).
- The exemption of supplies gives rise to misclassification and classification disputes as to what constitutes education and, therefore, the supply thereof. Such misclassification and disputes lead to incorrect VAT output treatment as well as input determination issues and complexities.

[3] According to the VAT Act you may not deduct any VAT charged on goods or services acquired to make exempt supplies

- There are increased compliance costs in having to calculate ratios in entities that make both taxable and exempt supplies. One of the supporting reasons for the exemption of education, as provided in the VATCOM, was that it would give rise to a reduced administrative burden for educational institutes. However, there has been the opposite effect for educational institutions that also make taxable supplies as these now have substantially increased administrative costs by having to apply apportionment ratios in determining permissible input tax deductions. Furthermore, due to its technical and complex nature it may not be uncommon to find educational institutions that are not aware of the technical requirements they face (Deloitte, 2015).

2.7. Conclusion

Educational services are an exempt supply under section 12(h) of the VAT Act. The main reason for the exemption of educational services is that many of the educational institutions providing educational services were financed by the government. Any increase in the cost of these educational institutions would be financed by increased contribution by the State and there would be no net gain to the State if it were subject to tax. There would merely be an increase in the administrative burden of these institutes. However, over the years, the activities of educational institutions providing educational services have changed drastically and a reduced number of institutes are wholly subsidized in terms of government subsidies. In order to supplement government subsidies and increase income, these institutions have increased their taxable activities considerably. This has resulted in educational institutions providing exempt and taxable supplies. Complexities are created in implementing the provisions of the VAT Act, whereby these institutes are required to carry out an apportionment exercise to account for these mixed supplies. This practice is inefficient and not cost effective. Furthermore, the ease of compliance, which was the basis in implementing the exemption, is diminished, as registration for VAT purposes is unavoidable.

The main reason for exempting educational services as stated above is in most cases no longer valid. When the objective and intention of the legislation is no longer satisfied, it must be reassessed and the treatment relating thereto re-examined. Therefore, exempting educational services is no longer valid as the objective and intention of the legislation to reduce the administrative burden for educational institutions is no longer met.

3. Is zero-rating a better alternative to the current VAT treatment?

This chapter will analyse whether zero-rating educational services is a better alternative VAT treatment to be used. The analysis will be performed by examining the criteria for zero-rating certain goods, services in South Africa, and determine whether educational services meet these criteria. Further, an analysis of the Australian tax treatment of educational services will be analysed, as the South African VAT Act is similar to Australia's GST Act.

3.1. Criteria for zero rating goods and services

A policy decision was taken before the introduction of VAT in South Africa in October 1991, to introduce a broad-based VAT system with concessions such as zero-ratings and exemptions restricted to a minimum. It was decided that the underprivileged would be assisted as far as possible outside of the VAT system. However, due to pressure from the affected groups and government's inability to provide assurance that assistance will be provided to the underprivileged to compensate for the effect of the VAT, several last minute concessions had to be introduced to ensure the smooth introduction of the tax. As a result, the VAT system in operation in South Africa today is more differentiated and has a narrower base than was originally intended (National Treasury, 2015: 4).

Zero-rating was introduced to reduce the regressiveness of the VAT system. Certain merit goods are zero-rated to produce a more equitable VAT, which reduces inequality. Zero-rating may also be seen as an instrument to combat poverty[4] (Jansen & Calitz, 2015). Moreover, certain items may also be zero-rated when it is considered as politically desirable to encourage consumption e.g. fuel(Kearney, 2003).

Zero rating is a more favoured treatment under the VAT system than exemptions. Where goods and services are zero-rated, no tax is charged on the on supply of the goods and services but any input tax paid is allowed as a credit. In effect, no tax is imposed on the value added by the vendor supplying the goods or services and all taxes paid in the previous stage are refunded (Value-Added-Tax Committee, 1991:4). Where goods and services that are supplied qualify as exempt supplies (as discussed in chapter 2) no input VAT incurred for making those supplies may be deducted.

[4] Since the underprivileged generally spend a greater proportion of their income on consumption goods than people who are, more affluent, such a tax places a relatively greater burden on the former (i.e. it is a regressive tax). To counter this, some goods have been zero rated, which means that a zero VAT rate applies to certain basic products. This reduces the burden of the tax on low-income consumers and improves tax equity.

3.2. Will educational services qualify for zero rating?

The reclassifying of a supply as a zero-rated supply is a policy decision. The Davis Tax Committee specifically recommended that exemptions and zero-rated supplies in the VAT Act be reduced as far as possible and that no new categories be introduced (The Davis Tax Committee, 2015: 13). This approach is aligned with global best practice to minimise the distortions and potential abuse[5] caused by exemptions and zero-rated supplies (Theron, 2015).

From an operational perspective, it is important to consider the rationale for reclassifying educational services as zero-rated supplies (Theron, 2015). One of the main reasons will be to reduce the administrative burden educational institutions are currently facing. Furthermore, educational institutions will receive additional funding via the release of input tax credits if educational services are zero rated. In light of the recent 'fees must fall' protests it is my view that educational institution may use this additional funding to decrease tuition fees as the burden of the 'hidden' or 'trapped cost' will not be passed onto the student.

Education is a basic human right and is essential for social and economic development of a country. Therefore educational services will qualify for zero rating, as it is a necessity for most humans and will be politically desirable to encourage consumption of education (Department for Democracy and Social Development Education Division, 2001:11)

3.3. Design of Australia's GST system vs South Africa's VAT system.

Australia's has a unique GST system that is difficult to classify as either a modified worldwide system or a modified territorial system. A territorial VAT system is imposed on a registered person's taxable supplies made in the taxing country while a worldwide VAT is imposed on all supplies made by a person subject to the countries tax jurisdiction, without regard to the location of the supply. The Australian GST system mixes these two (Lang et al, 2009: 269). The Australia GST is basically territorial but has a unique set of place of supply rules. Australia imposes GST on taxable supplies by a registered person in the course of an enterprise conducted by that person but only if the supplies are 'connected with Australia'.

The supply will be 'connected with Australia' if (Minter Ellison, 2016):

- In the case of goods, the goods are delivered in Australia, made available in Australia or are imported into or exported from Australia,

[5] Concessions (i.e. zero-ratings and exemptions) will normally distort consumer and producer choices and preferences, often resulting in a snowball-effect of subsequent requests for concessions (to counter the effect of the original concession)

- in the case of real property (including an interest in, or right over, land), if the real property is located in Australia,

- in the case of anything other than goods and real property, if the 'thing' is done in Australia or supplied through an enterprise carried on through a permanent establishment in Australia. If the 'thing' is neither done in Australia nor supplied through an enterprise carried on through a permanent establishment in Australia, and the 'thing' is a right or option to acquire another thing that would be connected with Australia, then the supply will be connected with Australia.

To obtain personal jurisdiction over a person on the basis of the person's operation of an "enterprise", the GST system largely relies on the "permanent establishment" concept applied for income tax purposes (Lang et al, 2009). As seen above the GST system includes distinctive rules that specify when goods and real property are considered connected and rules that specify how "*anything else*", for example, in terms of services, is treated as connected. These rules as a whole have a direct link to the direction adopted by the worldwide structure (Deloitte, 2015).

South Africa on the other hand functions on a worldwide tax system, whereby a vendor must report all supplies connected with his enterprise wherever they occur. In other words, the imposition of tax does not depend on the place where the supply occurs. Although South Africa does not have distinct place of supply rules, once an entity carries on a sufficient level of activity to be considered as carrying on an enterprise in South Africa, all supplies made by that entity are deemed to be made in the Republic, irrespective of their actual location and generally without regard to the place of performance of the supply (Silver & Beneke, 2015)

The term "enterprise" for South African VAT purposes is described as "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" (Lang, 2009: 269:270)

It is therefore apparent that Australia's GST system and South Africa's VAT system are highly similar although the view from the outset may seem different (Deloitte, 2015).

3.4. Economic consideration and state objectives

In adopting a zero-rating approach for educational services in South Africa, it is important to examine the laws adopted and applied in Australia with specific regard to the treatment and precedent that is similar to South Africa in this regard (Deloitte,2015).

South Africa's political objective with regard to education is to ensure all learners have access to quality education without discrimination and to increase the amount of skilled youth by expanding access to education, which will increase economic growth (as discussed in chapter two) (Council on Higher Education, 2016: 9). Australia shares similar views with South Africa in respect of economic and political treatment and objectives of education.

The Australian government's objective towards education is to promote equity and excellence and to ensure all students acquire the knowledge and skills to participate effectively in society and employment in a globalized economy (Australian Curriculum, Assessment and Reporting Authority, 2011).

These objectives are further supported by the The Higher Education Participation and Partnerships Program (HEPPP), which aims to ensure that Australians from low socioeconomic status (SES) backgrounds who have the ability to study at university have the opportunity to do so. It provides funding to assist universities to undertake activities and implement strategies that improve access to undergraduate courses for people from low SES backgrounds, as well as improve the retention and completion rates of those students (Australian Government Department of Education and Training, 2018).

3.5. Reason for making certain educational services GST free

In its policy document the Australian Government provided the following rationale for making educational services GST-free. It stated that (Australian Government the Treasury: Chapter 5):

'Like health and medical care, education receives significant government assistance. Public primary and secondary education is provided free of charge and significant assistance is given to private schools and tertiary and vocational education. Applying the GST to education would discriminate against private providers.'

This also accords with the Committee's Terms of Reference, which requested it to:

'…ensure the tax system minimises any discrimination between private and public provision of goods and services in the GST-free areas.'

Many submissions argued that education was a 'public good' and on this basis alone should receive special tax treatment. The Committee recognised the 'merit' argument, but chose to focus on the level 'playing field' guidelines

provided by the government. Its recommendations were based on the necessity to ensure that recognised public and private providers of educational goods and services are treated equally (Australian Government the Treasury: Chapter 5).

The Committee did not accept the proposal by a number of organisations that some form of 'blanket' GST-free status be granted with reference to a level of institution. In determining the scope of GST-free courses and institutions, the Committee had taken the approach that it is most desirable which was to use existing legal definitions and to add to these to the extent necessary. Such an approach was more likely to result in the government receiving recommendations, which are in a form that is readily transferable into legislation. It also added to simplicity and clarity in understanding the Committee's recommended scope of GST-free education (Australian Government the Treasury: Chapter 5).

After due consideration, the Committee came to the view that an appropriate way to define the scope of many of the courses and institutions qualifying for GST-free treatment is by reference to the Education Minister's Determination of Education Institutions and Courses under Subsections 3(1) and 5(D) of the *Student Assistance Act 1973* (Australian Government The Treasury: Chapter 5).

The Minister for Education, Training and Youth Affairs Minister retains the power, under the *Student Assistance Act 1973*, to make determinations identifying approved education institutions and courses. These determinations are referred to in the *Social Security Act 1991* to identify courses which qualify for particular types of assistance (for example, Youth Allowance) (Australian Government The Treasury: Chapter 5).

3.6. GST treatment of educational services in Australia

The GST law treats various education and related supplies as GST-free including the supply of education courses, related excursions or field trips and course materials. The effect of this is that the supplier does not charge GST on the supply, but will nevertheless be entitled to input tax credits for GST charged on acquisitions it makes in carrying on its enterprise (Wolters Kluwer, 2017).

There is, however, no blanket GST-free treatment of education and related supplies. Indeed, many kinds of supplies will be taxable (provided the supplier is registered) such as the supply of private tuition by a freelance tutor to a student, the supply of

certain grants to teachers and lecturers, and the supply of transport to and from school by a bus company (Wolters Kluwer, 2017).

It is important to understand at the outset that the mere fact that a supply is made by a school or university does not mean that the supply will automatically be GST-free. Schools and universities must therefore examine the range of supplies they make on a case by case basis to determine whether they need to charge GST.

Section 38-85 of a New Tax System (Goods and Services Tax) Act 1999 ("GST Act") states that:

"a supply is GST-free if it is a supply of:

*a) an **education course**; or*

b) administrative services directly related to the supply of such a course, but only if the supplier of the course supplies them. "

The application of the law is restrictive in terms of determining which education courses would qualify for the GST-free treatment, as it is governed in terms of the definitions in the relevant Education Acts. Due to the issues discussed around defining 'education institute' and the relevance relating thereto, full extracts of the definitions set out in section 195-1 of GST Act is provided below:

*"**education course** means:*

(a) a pre-school course; or
(b) a primary course; or
(c) a secondary course; or
(d) a tertiary course; or
(f) a special education course; or
(g) an adult and community education course; or
(h) an English language course for overseas students; or
(i) a first aid or life saving course; or
(j) a professional or trade course; or
(k) a tertiary residential college course.''

***"pre-school course** means a course that is delivered:*

(a) in accordance with a pre-school curriculum recognised by:
(i) the education authority of the State or Territory in which the course is delivered; or

(ii) a State or Territory body that has the responsibility for recognising pre-school curricula for courses delivered in that State or Territory; and

(b) by a school that is recognised as a pre-school under the law of the State or "

***"primary course** means:*

(a) a course of study or instruction that is delivered:

(i) in accordance with a primary curriculum recognised by the education authority of the State or Territory in which the course is delivered; and

(ii) by a school that is recognised as a primary school under the law of the State or Territory; or

(b) any other course of study or instruction that the Education Minister has determined is a primary course for the purposes of this Act."

***"school** means an institution that supplies pre-school courses, primary courses, secondary courses or special education courses but not any other education course."*

***"secondary course** means:*

(a) a course of study or instruction that is a secondary course determined by the Education Minister under subsection 5D(1) of the Student Assistance Act 1973 for the purposes of that Act; or

(b) any other course of study or instruction that the Education Minister has determined is a secondary course for the purposes of this Act."

***"tertiary course** means:*

(a) a course of study or instruction that is a tertiary course determined by the Education Minister under subsection 5D(1) of the Student Assistance Act 1973 for the purposes of that Act; or

(aa) a course of study or instruction accredited at Masters or Doctoral level and supplied by a higher education institution or a non-government higher education institution; or

(b) any other course of study or instruction that the Education Minister has determined is a tertiary course for the purposes of this Act."

***"Education Minister** means the Minister administering the Student Assistance Act 1973."*

***"higher education institution** means an entity that is a higher education provider as defined in section 16-1 of the Higher Education Support Act 2003."*

***"non-government higher education institution** means an institution that is not a higher education institution and that:*

(a) is established as a non-government higher education institution under the law of a State or Territory; or

(b) is registered by a State or Territory higher education recognition authority."

***"special education course** means a course of education that provides special programs designed specifically for children with disabilities or students with disabilities (or both)."*

***"adult and community education course** means a course of study or instruction that is likely to add to the employment related skills of people undertaking the course and:*

(a) is of a kind determined by the Education Minister to be an adult and community education course and is provided by, or on behalf of, a body:

(i) that is a higher education institution; or

(ii) that is recognised, by a State or Territory authority, as a provider of courses of a kind described in the determination; or

(iii) that is funded by a State or Territory on the basis that it is a provider of courses of a kind described in the determination; or

(b) is determined by the Education Minister to be an adult and community education course."

***"English language course for overseas students** means a course of study or education supplied to overseas students that:*

(a) includes study or education in the English language; and

(b) is supplied by an entity that is accredited to provide such courses by a State or Territory authority responsible for their accreditation."

***"first aid or life saving course** means a course of study or instruction that:*

(a) principally involves training individuals in one or more of the following:

(i) first aid, resuscitation or other similar life saving skills including personal aquatic survival skills but not including swimming lessons;

(ii) surf life saving;

(iii) aero-medical rescue; and

(b) is provided by an entity:

(i) that is registered (or otherwise approved) by a State or Territory authority that has responsibility for registering (or otherwise approving) entities that provide such courses; or

(ii) that is approved to provide such courses by a State or Territory body that has responsibility for approving the provision of such courses; or

(iii) that uses, as the instructor for the course, a person who holds a training qualification for that course that was issued by Austswim Limited (ACN 097 784 122); or

(iv) that uses, as the instructor for the course, a person who holds a training qualification for that course that was issued by Surf Life Saving Australia Limited (ACN 003 147 180); or

(v) that uses, as the instructor for the course, a person who holds a training qualification for that course that was issued by The Royal Life Saving Society—Australia (ACN 008 594 616); or

(vi) that uses, as the instructor for the course, a person who holds a training qualification for that course that is a qualification (in life saving) specified in, or of a kind specified in, the regulations."

***"professional or trade course** means a course leading to a qualification that is an essential prerequisite:*

(a) for entry to a particular profession or trade in Australia; or

(b) to commence the practice of (but not to maintain the practice of) a profession or trade in Australia."

***"tertiary residential college course** means a course supplied in connection with a tertiary course at premises that are used to provide accommodation to students undertaking tertiary courses."*

It is evident from the above that education and its fundamental levels is defined in the Australian GST system, and that the tax treatment employed follows the particular types of education services supplied. The rate applicable is based on a test of whether the course is aimed primarily at developing occupational skills. If aimed at developing such skills, it will be zero-rated, however if the course is recreational, the fees will be taxable at the standard rate (Deloitte, 2015)

In order to ascertain whether an organization qualifies for the zero rating several aspects need to be considered such as (Deloitte, 2015):

- The entity supplying the education;
- the course description and structure
- the type of educational course being supplied
- the type of accreditation the entity has and its application to the education course supplied;

- how is the education course is provided and any associated items that may be provided with the supply of the education (i.e. accommodation, course materials, excursions or meals)

The GST free treatment for professional or trade courses and tertiary courses will be examined in further detail below:

3.6.1. Professional or Trade courses that are GST free

The Australian GST Ruling GSTR 2003/01, provides a detailed explanation as to the meaning of a professional trade or course and what it encompasses. Furthermore, consideration is given to extend the definition to courses that run through workplace training including apprenticeship, various educational institutions, professional or trade associations, and government and non-government bodies who supply education or training leading to qualifications for entry. The courses that are potentially covered by this Ruling range across diverse professions and trades, including trades relating to the licensed operation of various equipment or machinery. (GSTR 2003/1 GST, 2015).

The course you supply will be a professional or trade course as defined above if:

- it is a course leading to a qualification; and
- the qualification is an "essential prerequisite".

The term "essential prerequisite" is defined in section 195-1 of the GST Act in the following terms:

*"a qualification is an **essential prerequisite** in relation to the entry to, or the commencement of the practice of, a particular profession or trade if the qualification is imposed:*

a) by or under an industrial instrument; or

b) if there is no industrial instrument for that profession or trade but there is a professional or trade association that has uniform national requirements relating to the entry to, or the commencement of the practice of, the profession or trade concerned — by that association; or

c) if neither paragraph (a) nor (b) applies but there is a professional or trade association in a State or Territory that has requirements relating to the entry to, or the commencement of the practice of, the profession or trade concerned — by that association."

If a person cannot enter, or commence practicing in, a profession or trade without a particular qualification, a course that leads to that qualification is a professional or trade course (GSTR 2003/1 GST, 2015).

There needs to be a direct link between the course and the qualification that is required for entrance to a specific profession or trade course when deciding whether the course is GST free. If a sufficiently direct link does exist, then the course is a professional or trade course (GSTR 2003/1 GST, 2015).

3.6.2. Tertiary educational courses that are GST free

The Australian GST system specifically makes provision for the definition of tertiary education and the degree of courses it encompasses. Tertiary courses includes all tertiary courses covered by the determination issued by the Education Minister under the Student Assistance Act 1973. This determination is also used to identify those courses that students must be undertaking to be eligible for income support as full-time students. The Education Minister reviews the eligibility of courses for the Student Assistance Act 1973, periodically. In determining whether an education course is an approved tertiary course, it does not matter to whom the course is delivered, as it will be GST-free regardless of whether it is delivered to resident students or non-resident students studying in Australia (GSTR 2001/1 GST, 2015).

A tertiary course also includes a course of study or instruction accredited at Masters or Doctoral level and supplied by a higher education institution or a non-government higher education institution. A distinction is made between private higher education and one that is governed by the State. In applying a GST free rate to tertiary education, an effective recovery of costs is facilitated to compensate for the out of scope services these institutes supply in comparison to services delivered at a school level. Therefore a differentiation is made and relief is granted (GSTR 2001/1 GST, 2015).

Paragraph (b) of the definition of a tertiary course allows the Education Minister to determine, independently of the requirement set out in paragraph (a), whether a course is a tertiary course as defined in section 195-1 of the GST Act (GSTR 2001/1 GST, 2015).

One of the determinations, which the Education Minister has made in this regard, was to extend the definition of tertiary course to include courses provided on a part-time basis. Such courses are not otherwise covered by the definition because the determination made by the Education Minister under subsection 5D (1) of the GST Act requires that a tertiary course is a full-time course.

3.6.3. Fees charged by Universities

Universities and educational institutions charge miscellaneous fees of various descriptions. In determining whether a miscellaneous fee is subject to GST, the supplies made to students must be identified in respect of payment of the fee (GSTR 2001/1 GST, 2015).

The fee paid for the supply of administrative services and/or the provision of facilities that are directly linked to the supply of GST- free education will also be GST-free if the supplier of that course supplies these services.

In certain circumstances, the following associated supplies are also GST-free:

- administrative services;
- course materials;
- excursion or field trip.

Supply of administrative services

A supply of administrative services made by a tertiary educational institution that is directly related to the supply of an education course is GST-free under paragraph 38-85(b) of the GST Act (GSTR 2001/1 GST, 2015).

"Directly related" is not defined in the Act and therefore, takes on its ordinary meaning. *The Macquarie Dictionary* defines "directly" to mean "*in a direct line, way or manner; immediately; absolutely*". The term "related" means, "*associated; connected or allied by nature*".

The phrase "directly related" was considered in the context of being "directly related to employment" for income tax purposes in *FC of T v Dixon* (1952) 86 CLR 540, at 553-554:

"A direct relation may be regarded as one where the employment is the proximate cause of the payment, an indirect relation as one where the employment is a cause less proximate, or, indeed, only one contributory cause".

Therefore, administrative services must be in a direct line or immediately associated or connected with the supply of the education course. Administrative services provided by an entity other than the supplier of the course will be subject to GST (GSTR 2001/1 GST, 2015).

The Act does not outline the administrative services that are directly related to the supply of an education course. However, the Australian tax officer considers that the supply of administrative services includes:

- program changes;
- enrolment services, including the processing of late enrolments;
- late issue or replacements of student cards;
- examination arrangements and assessments of students including re-assessment of results where a student has failed;
- processing academic results including duplicate degree copies;
- overdue charges or late payment charges;
- record-keeping;
- administration of the library;
- administration of a textbook scheme;
- administration of the supply of course materials;
- graduation certificates;
- course reinstatement;
- charges for HECS statements.

This is not an exhaustive list (GSTR 2001/1 GST, 2015).

Supply of course materials

If tertiary educational institution charges a fee for the supply of course materials as part of subjects undertaken in an education course, the supply is GST-free under section 38-95 of the GST Act.

"Course materials" is defined to mean "materials provided by the entity supplying the course that are necessarily consumed or transformed by the students undertaking the course for the purposes of the course".

Therefore, in determining whether materials or items will be considered to be course materials, all of the following requirements must be met:

- The materials or items are provided by and educational institution to students; and
- The materials are necessarily consumed or transformed by the students undertaking the course; and
- The materials are consumed or transformed for the purpose of the course.

Materials such as textbooks retain their generic application for other purposes and are not consumed or transformed in the manner outlined above (GSTR 2001/1 GST, 2015).

Where a supply of course materials includes parts that are taxable and other parts that are GST-free, educational institutions may be required to determine the value of the taxable part. A reasonable method to work out the taxable portion of the supply may be used however, what is "reasonable" will depend on the facts of each case (GSTR 2001/1 GST, 2015).

Supply of an excursion or field trip

A supply of an excursion or field trip will be made where the tertiary educational institution coordinates the various elements for the recipients of the supply. These elements may include entry fees, charges for equipment and activities, transport costs, food and accommodation (GSTR 2001/1 GST, 2015).

If the excursion or field trip supplied to a student is directly related to the tertiary educational institutions curriculum, and it is not predominantly recreational in nature, the supply will be GST-free, except for any food or accommodation supplied (GSTR 2001/1 GST, 2015).

"Predominantly" is not defined in the GST legislation and takes on its ordinary meaning. *The Macquarie Dictionary* defines predominantly to mean, "*to be the stronger or leading element, to be more noticeable or imposing than something else, to dominate or prevail over*".

To determine whether an excursion or field trip is predominantly recreational, all the relevant factors relating to the activities in the excursion or field trip must be considered. For instance, the time, cost or purpose of the excursion or field trip would be relevant in determining whether the activities are predominantly recreational (GSTR 2001/1 GST, 2015).

In terms of the Australian jurisdiction, it appears that an analysis is made in respect of the level and value added tertiary educational institutes offer in comparison to other institutes, as this distinction is made independently and included in the definition of “education course”.

Tertiary educational institutes differ in comparison to primary educational institutes in terms of the purpose they serve, ranging from both occupational programs to academics and research. These programs provide access to a higher level of education with a vast degree of possibilities that serve multiple functions. As these academic programs constitute a higher degree of learning, and prepare the learner for a specific trade, the costs associated in relation cannot be equated and paralleled to the same gradation as that of the primary education scale (Deloitte, 2015). Thus, these additional costs should not be pooled collectively but segregated in terms of complexity and degree of value added. The Australian GST system, by providing such distinction in education and course class, provides ample relief for these tertiary educational institutions and therefore mitigates the burden of excessive costs on the students (Deloitte, 2015).

3.6.4. Recommendations

It is recommended that the VAT treatment of educational services in South Africa should be changed from exempt to zero-rated; this will reduce the administrative burden most educational institutions currently face and will keep with the original intention of the VATCOM.

Furthermore educational institutions will have additional funding via the release of input tax credits if educational services are zero rated which may result in a decrease in tuition fees as the burden of the ‘hidden’ or ‘trapped cost’ will not be passed onto the student.

Should there be a concern towards the potential abuse of the VAT system, a limitation could be formulated to permit the zero rating to those institutes only, whom upon dissolution are required to transfer their assets to another institute carrying on similar activities (i.e. limit the zero rating to educational institutions which qualify as Public Benefit Organizations (PBO’s)) (Deloitte: 2015).

Alternatively a VAT treatment similar to Australia should be adopted wherein a distinction is made between the different level of educational institution and the method of VAT treatment applied, be aligned thereto. Therefore a blanket zero-rated VAT treatment should not be applied to the entirety of the education services,

but special concession be made individually in terms of the degree and level of knowledge transferred.

Consequently, a combination of the zero or standard rating may be employed dependent on the classification, class and level the institution belongs to. This will provide various avenues of relief and decrease the burden of non-recoverable VAT. Furthermore, a definition of educational services should be introduced and specific guidance should be provided by SARS on what services directly related to the supply of educational services qualify for zero- rating which is similar to what Australia does. In order to maintain a form of equalization, institutions who do not meet the requirements laid out would then standard rate such supplies.

3.7. Conclusion

In conclusion, the Australian GST system provides a more beneficial treatment for educational services. There is no singular treatment to be applied to the entirety of the education services, such as the standard zero rating, but special concession is made individually in terms of the degree and level of knowledge transferred.

At the outset, the Australian GST system may seem distinctive in terms of regulation and the basis of their GST base; however, it is still a modern GST system with considerable traits in the direction of the worldwide position, which South Africa adopts. The two States government's intention and objectives towards education are similar, in that the socio economic needs of the underprivileged and the accessibility of education to the masses is uniform in terms of what both governments' are trying to achieve. As such, Australia provides valuable guidance on VAT principles and treatment, which may and should be applied in respect of educational services.

It is recommended that all educational services be zero–rated. As stated above the change would allow for reduced administrative burden. Alternatively a distinction be made between the different class of educational institutes and the method of VAT treatment applied, be aligned thereto. This will provide various avenues of relief and decrease the burden of non-recoverable VAT

4. Alternative VAT treatments for educational services

This chapter analyses the alternative VAT treatments that exist to tax educational services. The impact the current VAT treatment has on private educational institutions will also be discussed. Lastly, recommendations to the current VAT treatment are provided should the alternative methods suggested not be feasible.

4.1. Applying a reduced rate to educational services

A less favourable recommendation will be to tax educational services at a reduced rate[6], similar to the current treatment of long-term commercial accommodation. This will simplify the compliance responsibility and simplify the VAT treatment, as educational institutions will not have to perform complex apportionment calculations. In addition, this would have the effect of placing the sector in a VAT-neutral position in which the output tax payable on tuition fees would be funded by the additional input tax deduction that would become available avoiding the necessity of increasing tuition fees (PricewaterhouseCoopers, 2015).
Not only would the VAT cost be reduced, but also managing the VAT risk in the sector would become a much easier task (PricewaterhouseCoopers, 2015).

New Zealand standard rates the GST treatment for education. The mechanics of the New Zealand GST and the breadth of its tax base is examined in further detail below.

4.1.1. New Zealand's approach to standard rating educational services

New Zealand follows a modern VAT system as opposed to the traditional VAT system and does not exempt education. The modern VAT system has a single VAT rate and a much lower VAT rate compared to countries with a traditional VAT system (Deloitte, 2015). The system has no merit concessional exemptions with limited exemptions and has illustrated that services supplied by governmental institutions or public bodies can be included in the VAT system (Giles, 2000)

New Zealand is the leader in extending the VAT base to a large part of the public sector. Barrand (1991) indicates four arguments that support taxing government departments and local authorities in New Zealand: "These are administrative simplicity, accountability and transparency of government operations, comprehensiveness of GST coverage and sound economic management." There is

[6] HESA submitted a formal request to the Davis Tax Committee on February 26, 2015 recommending that educational and related services be subject to VAT at a reduced rate. The request also emphasised that further investigation needed to be conducted to determine what this rate should be.

no economic and equity rationale for taxing public organizations more lightly than private firms (Minh Le, 2003).

As a result, the primary reason for taxing certain supplies such as educational services is that it levels the playing field between publically and privately provided education and preserves a competitive relationship between the state and private sectors (Mirrlees, 2010: 403).

New Zealand is of the opinion that there is no merit to concessional exemptions and rejects applying exemptions to subsidised particular activities. The modern VAT system is a "*broad-base VAT with a low single standard rate, a low registration threshold, and few exceptions and exemptions*" (Charlet et al, 2010). Furthermore, New Zealand scores the highest on the 'OECD VAT revenue ratio', which indicates that New Zealand has implemented an administrative efficient and neutral VAT system, which is preferable to the European Union traditional VAT system, which applies several exemptions and reduced rates (Ebrill et al, 2001). As a result, New Zealand does not exempt educational services, as there is no reasoning for such exemption.

The primary reason highlighted in both the Australian and New Zealand GST treatment of education is the levelling of the playing field between government and private educational institutions and not discriminating against private educational institutions. It is therefore important to understand how the current VAT treatment in South Africa affects private educational institutions.

4.1.2. The impact of the current VAT treatment of educational services on private educational institutions

Section 12(h) of the VAT Act provides that the supply of educational services by private colleges that are established, declared or registered under the FET Act is exempt from VAT.

Prior to March 2002, the exemption extended only to supplies made by the government. However effective from 1 March 2002, the section exempted supplies by the government as well as further education and training institutions registered under the FET Act (Deloitte, 2016)

The section hereby brought private FETs registered under this Act into the ambit of the exemption. There was no specific communication or any information sessions that advised or alerted relevant private FETs of this change in legislation. As a result, many private FETs continued to charge 14% VAT, as they were unaware of the

impact that these changes had on the VAT treatment of their services (Deloitte, 2016)

This amendment created an anomaly as non-compliant suppliers who did not register under the FET Act could continue to charge VAT and claim input tax on related expenses, as the supplies by these entities did not qualify as exempt supplies. This meant that entities who were incorrectly not registered under the FET Act were allowed to remain on the VAT register and charge VAT on their supplies (with the right to deduct input tax). Suppliers that were registered under the FET Act were however 'penalised' by the fact that their supplies were now exempt without the right to deduct input tax. The word penalised is used since the VAT on the costs incurred by a vendor making taxable supplies qualify for input tax deduction (Deloitte, 2013).

A subsequent notice on 1 June 2006 indicated that no person is permitted to offer FET qualifications unless registered or provisionally registered as a private FET. This resulted in prompt registration of multiple FETs, which were by virtue of registration now brought into the exemption. Most of these entities were completely unaware of these changes and the impact they had on their VAT affairs (Deloitte, 2013).

In 2008, there was another amendment to section 12(h), whereby the words "established" and "declared" were added. The implication meant that the exemption was now extended to private training entities who were established or declared as FETs.

It is important to note that private institutes are not administered by local, state or national governments and thus they retain the right to select their students and are funded in whole or in part by charging their students tuition, rather than relying on mandatory public or government funding (Deloitte, 2018).

Private institutes operate in terms of securing contracts in order to provide training primarily to corporates. A large percentage of the services are provided to VAT registered vendors. In order to supply the training services, private institutes outsource the services to specialised training providers. Typically, the outsourcing company or sub-contractor charges VAT at the standard rate for the provision of such training services (Deloitte, 2018).

As seen from the above private institutions who absorb costs through their own funding, and are not primarily financed by the State, are prejudiced as they outsource the lecturing of courses to third parties and not entitled to recover VAT on these costs incurred. Moreover despite changes in the registration requirements with the Department of Education and VAT amendments, the VAT amendments

were not clearly communicated to all such institutions, which resulted in the general confusion as to when such institutions were required to register for or charge VAT and when they were not required to do so. As a result, a number of private educational institutions may still be non-compliant and may face severe penalties and interest charges by SARS.

Therefore, it is proposed that a reduced rate be applied to educational services. This will be in line with the initial intention of the legislation i.e. to keep the compliance burden to a minimum. It would also present the least amount of administration burden to the Government, in that it can be governed with less effort. Although this may not be the most favourable of options, it will at most provide a practical and efficient pathway of recovery that will eliminate the shifting of any trapped VAT that may be embedded in higher fees and tuition costs. In addition, like Australia and New Zealand it will level the playing fields between government and private educational institutions.

4.2. Inclusion of educational services of welfare organisation activities

4.2.1. VAT concession for Welfare organisations

To qualify as a "welfare organisation" for VAT purposes, the organisation must be a Public Benefit Organisation ("PBO") that has been approved by SARS for income tax exemption purposes and must carry on any of the following welfare activities, as determined by the Minister of Finance in terms of Regulation No 12 of 2005 under the following headings:

- Welfare and humanitarian
- Health care
- Land and housing
- Education and development
- Conservation, environment and animal welfare.

(SARS –LAPD, 2016:12-13)

In terms of Regulation No. 112 the welfare, activities relating to "*Education and Development*" extends to the following:

a) *"The provision of school buildings or equipment for public schools and educational institutions engaged in exempt activities contemplated in section 12(h) of the Value-Added Tax Act, 1991, for the benefit of the poor and needy and physically disabled.*

b) *Career guidance and counselling services provided to persons for purposes of attending any school or higher education institution as envisaged in section 12(h)(i)(aa) and (bb) of the Value-Added Tax Act, 1991.*
c) *Programmes addressing life skill needs of children at schools, pre-schools or educational institutions as envisaged in section 12(h) of the Value-Added Tax Act, 1991.*
d) *Educational enrichment, academic support, supplementary tuition or outreach programmes for the poor and needy.*
e) *Training for unemployed persons with the purpose of enabling them to obtain employment."*

Welfare organizations are allowed to conduct an enterprise and register for VAT even if their supplies are made for no consideration[7]. The benefit to a welfare organisation of registering for VAT is that it will be entitled to deduct input tax in respect of expenses related to its welfare activities, even where no consideration is charged on supplies made by it. In addition, a welfare organization is not precluded from conducting trading activities, at which the normal standard rate would apply (SARS –LAPD, 2016:13).

However to the extent that the organisation has activities involving the making of exempt supplies as listed in section 12 of the VAT Act, those activities do not form part of that organisation's enterprise. Therefore, a PBO will not automatically qualify as a "welfare organisation" for VAT purposes as this will be dependent on whether the institution conducts any of the listed welfare activities for VAT purposes and such activity, furthermore, is not specifically exempt for VAT purposes. Consequently the supply of educational services by a welfare organisation which is registered as one of the educational institutions as set out in section 12(h) , is an exempt supply. The welfare organisation is thus, to the extent that it makes these exempt supplies, notwithstanding the fact that it might be carrying on certain public benefit activities (PBAs), deemed not to be carrying on an enterprise. To this extent, the welfare organisation is not entitled to deduct any VAT incurred in the course or furtherance of making these exempt supplies (SARS –LAPD, 2016:16).

4.2.2. Deemed supplies

If a welfare organisation is a registered VAT vendor and receives payment from a public authority or municipality for the purposes of making taxable supplies to other persons, that vendor is deemed in terms of section 8(5) of the VAT Act, to supply a

[7] The definition of "enterprise" in section 1(1) specifically includes the activities of a welfare organisation to the extent that the activities carried on by the welfare organisation are welfare activities as listed in GN112.

service to the person making the payment (e.g. the Government) (SARS –LAPD, 2016:24-25).
However, section 11(2) (n) provides for an exception to the rule, if the recipient who receives payment from a public authority or municipality is a welfare organisation and the funds received are used for carrying on welfare activities. This deemed supply of a service is subject to VAT at the zero rate and, therefore, no output tax is payable on the funds received from a public authority or municipality (SARS –LAPD, 2016:24-25).

The above concessions provided to welfare organizations demonstrate that the VAT Act already provides a framework to govern and administer such entities (Deloitte: 2015). It is therefore recommended that educational services be removed as an exemption and be included as a welfare activity. This will allow educational institutions who previously could not register for VAT (e.g. Public or state schools and educational institutions) to register voluntarily in terms of the "welfare organisation" VAT rules. Furthermore educational institutions who are already registered for VAT who receive payments from Government will not have to account for output VAT as it will be considered a deemed supply in terms of section 8(5) which is zero rated in terms of section 11(n) of the VAT Act (SARS –LAPD, 2016:24-25).

While Government has reduced, the amount of funding provided to educational institution as highlighted above, it still comprises a significant portion of an educational institution's income.

4.3. Improvements to the current VAT treatment of educational services

Should the above recommendations not be feasible the following improvement to the current VAT treatment is recommended.

Educational services are currently exempt from VAT, but there are uncertainties around the exact definition of "educational services" and the VAT treatment of certain supplies and expenses.

As previously stated above the term educational services is not defined in either the VAT Act or in respect of the various Acts referenced in section 12(h), it stands to argue that educational services can only be termed or defined in terms of what it includes. Thus, while "educational services" have not been specifically defined in the VAT Act, it is nevertheless clear that services covered by the referenced Acts is included in the definition.

However, in terms of subsection (ii) to section 12(h), a reference has been made as to what "educational services" is meant to include.

Subsection (ii) of 12(h), includes:

"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 above if such goods or services are supplied for a consideration in the form of school fees, tuition fees or payment for board and lodging."

No guidance is provided in terms of what is considered "necessary for and subordinate and incidental" to the supply of educational services and what constitutes "school fees" and "tuition fees".

As a result, it is difficult for educational institutions to determine what can be included as educational services. It is therefore recommended that guidance[8] should be provided in terms of what supplies can be included as educational services with specific reference to fees such as registration fees, graduation fees, short course fees, admission/application fees, residence application fees, student levies, academic records, class notes and tour fees.

Educational institutions also usually provide accommodation for participants at workshops or sporting events. The VAT position relating to this accommodation was discussed in official rulings issued in August 1992, but these rulings were subsequently withdrawn in 2009.

The lack of guidance in this regard creates an increased risk for educational institutions as a result of these institutes misclassifying their supplies. This may lead to the incorrect direct attribution and apportionment calculations, which may lead to the understatement of output tax or the overstatement of input tax deductions. The aforementioned risks may result in a tax liability and penalties and interest for educational institutions for no justifiable reason but which may be primarily attributed to the complexities of applying the exemption correctly. (Keen & Smith, 2007)

Consequently, SARS needs to provide guidance in this regard as the administrative and financial burden for educational services is further increased by these institutions constantly having to request opinions from professional consulting firms and request rulings from SARS to clarify what constitutes educational services.

[8] Guidance from Australia's guides and rulings can be used in this regard.

4.4. Conclusion

If zero-rating educational services is not a preferred alternative method, there are other alternative methods available. Taxing education institutions at a reduced rate will be in line with the initial intention of the legislation to keep the compliance and administrative burden to a minimum. Moreover, it will level the playing field between government and private educational institutions. An alternate VAT treatment will be to include educational services as a welfare activity, this will allow educational institutions to claim input tax and educational institutions who receives government subsidies and grants will not have to account for output VAT. However all benefits will not be received by private institutions as they are not funded/or receive limited funding from the government subsidies and grants. Lastly if none of the above recommendations are feasible it is recommended that the current VAT treatment be improved by providing additional guidance on what supplies can be included as educational services. Guidance from the Australian VAT legislation, rulings and guides can be obtained in this regard.

5. Conclusion

Educational services are an exempt supply under section 12(h) of the VAT Act. The main reason for the exemption of educational services is that many of the institutions providing educational services were government institutions and to some extent financed by the government. However, over the years the activities of institutions providing educational services have changed drastically and a reduced number of institutes are wholly subsidized in terms of government subsidies. In order to aid government grants and increase income, these institutions have increased their taxable activities considerably. Furthermore, privately owned and semi-subsidized institutions are accountable for their own costs and are not provided any or limited support from government.

Numerous educational institutions within South Africa conduct an enterprise with the rendering of taxable supplies in addition to the provision of educational services. Such additional activities, provided the educational institute qualifies for and is VAT registered, are taxed at the standard rate. This in turn has created complications in administering the VAT Act, whereby these service providers are then required to carry out an apportionment of VAT for their mixed supplies. This practice is inefficient and not cost effective. Furthermore, the ease of compliance, which was the basis in implementing the exemption, is diminished, as registration for VAT purposes is unavoidable.

Educational institutions that render taxable supplies would be incurring inputs on associated costs. The effect of exempting educational services from the VAT net ultimately results in an increase in tuition fees as the burden of “hidden” or “trapped” cost is passed onto the student, as a result of the institution’s inability to claim a refund of the tax paid. As there is no recovery of input tax embedded in the price of exempt supplies, the cost of the tax included in the price must be borne by the entity that acquires the exempt supply and can only be recovered if the tax is passed on to customers. This is in effect contradictory to the initial intention of the government’s political and economic objective in respect of education, to ensure access to education to all on a non-discriminatory basis.

Furthermore, such treatment has effectively resulted in an increase in the administrative burden on private and semi-private institutions which is in conflict with the intention and objective of exempting educational services.

The main reason for exempting educational services as stated above is in most cases no longer valid. When the objective and intention of the legislation is no longer satisfied, it must be reassessed and the treatment relating thereto re-examined. Therefore,

exempting educational services is no longer valid as the objective and intention of the legislation to reduce the administrative burden for educational institutions is no longer met.

Zero-rating educational services is an alternative VAT treatment that can be applied which is adopted in Australia. The Australian GST system provides a more beneficial treatment for educational services. There is no singular treatment to be applied to the entirety of the education services, such as the standard zero rating, but special concession is made individually in terms of the degree and level of knowledge transferred.

At the outset, the Australian GST system may seem distinctive in terms of regulation and the basis of their GST base, however it is still a modern GST system with considerable traits in the direction of the worldwide position, which South Africa adopts. The two States government's intention and objectives towards education are similar, in that the socio economic needs of the underprivileged and the accessibility of education to the masses is uniform in terms of what both governments' are trying to achieve. As such, Australia provides valuable guidance on VAT principles and treatment that may and should be applied in respect of educational services.

It is recommended that the VAT treatment of educational services should be changed from exempt to zero-rated; this will reduce the administrative burden most educational institutions currently face and will keep with the original intention of the VATCOM. Furthermore educational institutions will have additional funding via the release of input tax credits if educational services are zero rated which may result in a decrease in tuition fees as the burden of the 'hidden' or 'trapped cost' will not be passed onto the student.

Alternatively a VAT treatment similar to Australia should be adopted wherein a distinction is made between the different level of educational institution and the method of VAT treatment applied, be aligned thereto. Consequently, a combination of the zero or standard rating can be employed dependant on the classification, class and level the institution belongs to. This will provide various avenues of relief and decrease the burden of non-recoverable VAT.

Other alternate methods available should the above-recommended VAT treatments fail is to apply a reduced rate to educational services or include educational services as a welfare organisation activity. Both these recommendations come with their own advantages and disadvantages however; both are in line with the initial intention of the legislation to keep the compliance and administrative burden to a minimum.

Lastly, if none of the above recommendations are feasible it is recommended that the current VAT treatment be improved by providing additional guidance on what supplies can be included as educational services, guidance from the Australian guides and rulings

can be obtained in this regard. This will reduce the risk for educational institutions, as there will be no misclassification of supplies, which may lead to the incorrect direct attribution and apportionment calculations and increase expenses for educational institutions.

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