Tax & Exchange Control

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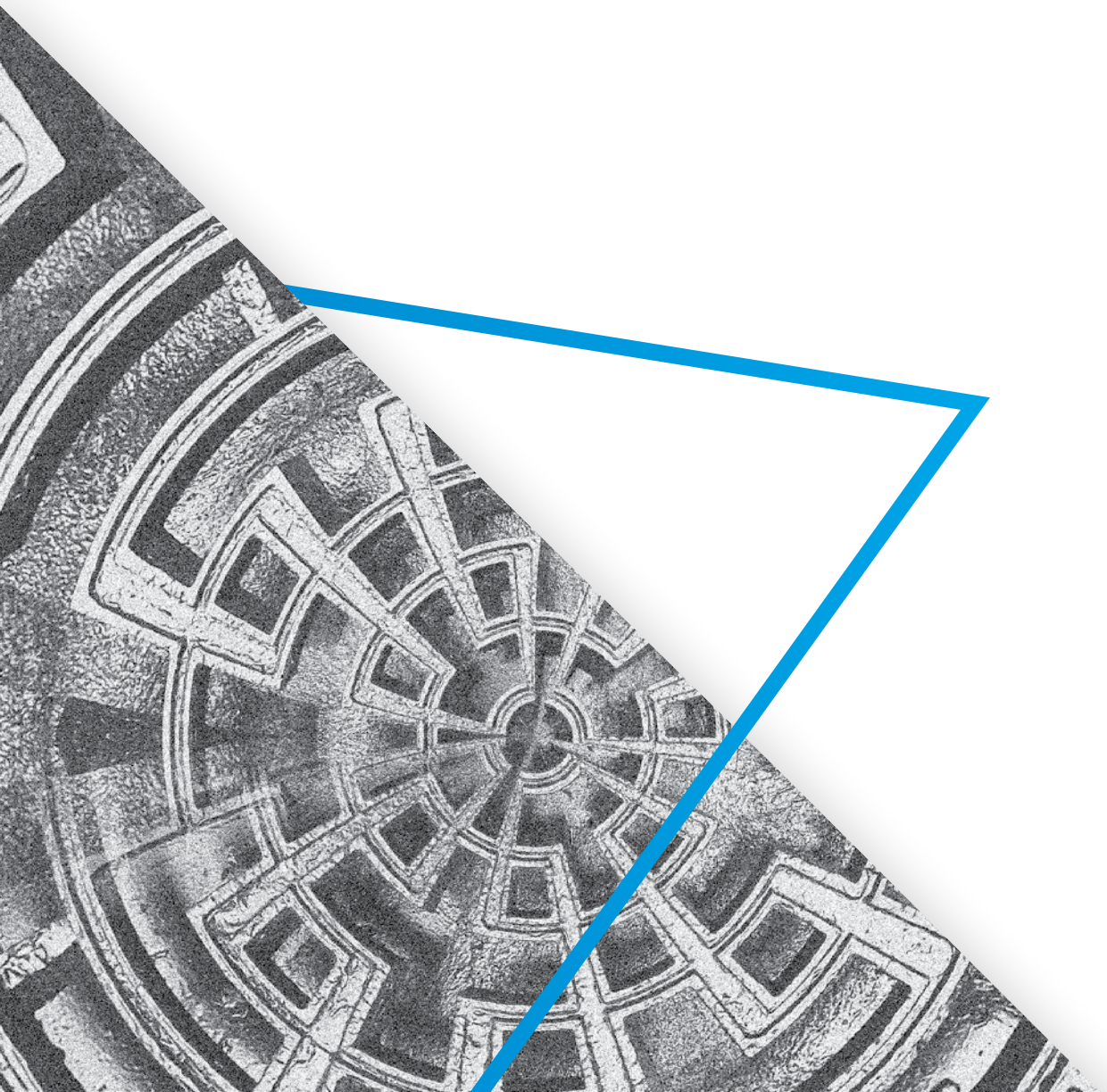

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VAT agency and principals

The terms "*agent*" and "*agency*" are not defined in the Value Added Tax Act 89 of 1991 (VAT Act). The South African Revenue Service (SARS) has indicated in Interpretation Note 42 (IN 42) that it accepts that the common law relationship between the principal and the agent prescribes the value-added tax (VAT) consequences of this legal relationship. The general VAT rule is that where a person, acting as agent, supplies goods or services on behalf of a principal to a third party, the supply is deemed to be made by the principal and not the agent (section 54(1) of the VAT Act). Conversely, where a third-party supplier makes a supply to an agent acting on behalf of a principal, that supply is deemed to be made to the principal (section 54(2) of the VAT Act). In these instances, the principal and not the agent must account for VAT on the supplies.

It is sometimes difficult to determine whether a person acts as an agent or a principal. Even more so when it comes to cross-border supplies, and particularly regarding services provided by tour operators and travel agents. Section 11(2)(*l*), which provides for the zero rating of certain services supplied to non-residents, has been amended several times. Some of these amendments were specifically aimed at clarifying the VAT status of supplies by tour operators. Notwithstanding these amendments, our courts are still being called upon to rule on whether local travel agents' supplies to foreign tour operators qualify for the zero rate.

Recent Tax Court judgment

In a recent case heard by the Cape Town Tax Court, *KEN CC v The Commissioner for the South African Revenue Service* (Case No VAT 22184) Dickerson AJ ruled that the vendor was entitled to apply the zero rate in terms of section 11(2)(*l*) to the commission it charged to foreign tour operators for assembling tour packages.

The taxpayer (KEN) led evidence that it is a destination management company whose function is to provide local tourist knowledge of South Africa to foreign tour operators, and to assist them with structuring tour packages for marketing and sale to their foreign clients. KEN assists the foreign tour operators to assemble tour packages by providing information regarding local conditions and supplies, acting as conduit between the foreign tour operator and local suppliers such as hotels, and implementing the foreign tour operators' specific requests.

The terms and conditions which govern the relationship between KEN and the foreign tour operator explicitly stipulate that KEN acts as the foreign tour operators' exclusive representative in South Africa to make bookings, reservations and payments in South Africa on behalf of the foreign tour operator. KEN adds a percentage to the prices it negotiates with the suppliers and includes this

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percentage in the quotations it provides to the foreign tour operators, as its commission. If a quotation is accepted, KEN issues an invoice to the foreign tour operator, which is required to pay the total amount before the tour commences. Upon receipt of payment, KEN sends emails confirming the bookings with the suppliers, which state that the confirmation is on behalf of the foreign tour operator.

KEN clarified with SARS in 2005 that it was acceptable to issue an invoice for amounts which included its commission, because it does not want to disclose the commission amount separately on the basis that the commission is confidential, and it is common industry practice not to disclose it. Furthermore, KEN only reflects the commission amounts in its financial records as income and does not deduct any VAT on the fees charged by the suppliers.

The arguments and decision of the court

KEN applies VAT at the zero rate to its commission, which it adds to the fees it negotiates with the suppliers. It contended that it provides a single supply of a service comprising of the assembly of tour packages to foreign tour operators who are outside South Africa at the time the service is rendered. The services are therefore zero-rated under section 11(2)(*l*).

SARS argued that KEN supplies the actual tourism services to the foreign tourists when they are in South Africa, and therefore paragraph (iii) to section 11(2)(*l*) excludes these services from the zero rate. Accordingly, SARS assessed the total amount on the invoices, including the commission at the standard rate. SARS took the view that by not disclosing its commission separately on its invoices, KEN was not acting as an agent but as a principal, and KEN was required to establish a "*trade usage*" in this regard, which is the custom that has the force of law.

The court held that it was sufficient for KEN to show that it is common practice in the industry to keep commissions confidential. Furthermore, disclosing the commission amount is not one of the *essentialia* of agency, and it is perfectly permissible for an agent and a principal to agree that commission is payable, but that the amount may not have to be disclosed.

Application of the judgment in *XO Africa Safaris v CSARS*

SARS also placed reliance on the Supreme Court of Appeal's judgment in *XO Africa Safaris v CSARS* (395/15) ZASCA 160 (3 October 2016) where the court held that the taxpayer supplied the tourism services to the foreign tourists, who consumed those services in South Africa, and that the tour packages supplied to the foreign tour operators were subject to VAT at the standard rate.

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However, Dickerson AJ stated that the facts in the *KEN* case were completely distinguishable from the facts in *XO Africa Safaris* on at least five grounds:

1. XO Africa Safaris reflected the total amounts invoiced to the foreign tour operators as revenue in its financial records, and it reflected the fees charged by the local suppliers as its own expenses. KEN only reflects the commission as income in its financial records.
2. XO Africa Safaris led evidence that its contracts with the foreign tour operators required it to provide the local services which it sold to the foreign tour operators. KEN does not provide tourism services and it does not deal with customer complaints other than as a conduit to the foreign tour operators.
3. XO Africa Safaris was responsible for delivery of the local services; it employed consultants to supervise this, and it was required to rectify problems with local suppliers. KEN has no obligation to deliver any local services to the tourists or to resolve problems with local suppliers.
4. The terms and conditions of the contract between XO Africa Safaris and the foreign tour operator stated that XO Africa Safaris provided materials and services consisting of accommodation, meals, entertainment, transport, etc. KEN does not undertake to supply any tourism services. It merely books and arranges for payment on behalf of the foreign tour operator.
5. XO Africa Safaris sought to zero rate the fee charged for the tour package to the foreign tour operator, and to deduct the VAT charged by the local suppliers as input tax, which would cause the fiscus to forgo the VAT charged by the local suppliers. KEN does not seek this additional benefit in deducting the VAT charged by the local suppliers.

The court took a dim view of SARS' approach in raising the assessments, which it said was inconsistent with the approval of KEN's invoicing in 2005, the criteria it (SARS) set out in IN 42, the evidence of the case, and SARS' misplaced reliance on the *XO Africa Safaris* case, which the court stated "*displays a careless disregard of the particular nature and modus operandi of KEN's business*". The court granted an order for the costs of KEN's two counsel, which is uncommon in the Tax Court, as this means it concluded that SARS' grounds of assessment or its "*decision*" were unreasonable, as contemplated in section 130 of the Tax Administration Act, 28 of 2011.

The takeaway

The *KEN* and *XO Africa Safaris* cases confirm that our courts determine the VAT status of a supply by considering the legal rights and obligations concluded between a supplier and recipient, in view of the surrounding circumstances and the conduct of the parties. Moreover, the importance of properly documenting the relationship between the parties to substantiate that a person acts in the capacity as an agent, is emphasised in this case.

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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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