DLA CLIFFE DEKKER HOFMEYR

TAX ALERT

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CLAIMING VAT INPUTS

In light of the decision in *Commissioner for the South African Revenue Service v De Beers Consolidated Mines Limited 74 SATC 330*, the current policy of the South African Revenue Service (SARS) is for a vendor to claim an input tax credit in respect of any Value-added Tax (VAT) paid on an expense, a direct or immediate link must exist between that expense and a taxable supply made by that vendor. The ultimate purpose for incurring the expense is ignored.

However if one considers the definition of 'input tax' in s1 of the Value Added Tax Act, No 89 of 1991 (VAT Act), the requirement is that goods or services must be acquired for "consumption, use or supply in the course of making taxable supplies". If one considers the current judgments where the phrase 'in the course of' was dealt with, there seems to be a clear indication that to claim the input tax, there must be some relationship between the consumption or use of the services or goods and the making of taxable supplies. In other words, the direct or immediate link to taxable supplies is not an actual pre-requisite. However, it is interesting to note that SARS continues to apply the direct or immediate link requirement test in spite of current and subsequent international case law which states otherwise.

For a vendor to be able to claim an input tax credit, the vendor must have acquired the goods or services for the purposes of making taxable supplies. In other words, the question is not whether there is a direct and immediate link between the services used and the taxable supply, but whether there is a sufficiently close relationship with the enterprise in the course of which the taxable supplies are made. If expenses are incurred for the more efficient performance of the business operations or generally linked thereto, the VAT input credit can be claimed for so long as there is no intervening exempt supply.

The question is whether the phrase 'in the course of making taxable supplies' conveys a wider meaning than the phrase 'for the purposes of his taxable transactions'? The Concise Oxford Dictionary defines the term 'in the course of' as being 'in the process' or 'during'. It is also important to note that unlike in the definition of 'enterprise', the phrase 'in the course or furtherance of' has not been used for the purposes of defining 'input tax'. The use of the words 'or furtherance of' would have conveyed a broader meaning in that they envisage a less direct or immediate relationship between the expenditure and the generation of taxable supplies, eg expenditure which facilitates as opposed to generates taxable supplies.

The European courts have, for the purposes of the European Community legislation and the United Kingdom domestic legislation, treated the terminology 'in making taxable supplies', 'for the purpose of making taxable supplies' and 'in the course of making taxable supplies' as being synonymous.

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In certain foreign case law certain principles were highlighted in determining 'in the course' and the direct and immediate purpose test. In *Customs and Excise Commissioners v UBAF Bank Ltd 1196 STC 37*, where expenditure was incurred to acquire shares, the most closely linked activity to such expenditure was the acquisition of the shares, which was not in itself held to be a taxable supply. The case of *BLP Group PLC v Customs and Excise Commissioners CJEC C-4-94 1995*, however, was held not to be authority for saying that the most immediate or proximate activity in relation to the expenditure had to constitute a taxable supply. What it did say was that if the immediate activity constituted an exempt supply then that would indeed break the causal link. As regards the invoices relating to the disposal of shares, the court had no difficulty in deciding in *RAP Group v Customs and Excise Commissioner CHD (2000) STC 980* that the ultimate objective was to generate taxable supplies in the form of management fees, the immediate purpose was to sell the shares and this constituted an intervening exempt supply which severed the causal link between the incurral of the expenditure and the generation of taxable supplies.

It would seem that in light of foreign case law, there is little basis for arguing that our test for determining what constitutes input tax is broader than that used in the European Community legislation.

Paragraph 3 of Practice Note 4, which deals with the provisions of s 241(2), provides as follows:

> *"The test of whether a transaction is entered into in the course of any trade and whether such trade is carried on within the Republic, always depends on the actual circumstances of the specific case. A euro loan (exchange item) entered into by a taxpayer and utilised to finance a productive asset, such as manufacturing equipment would normally be considered to be incurred in the course of the taxpayer's trade. The loan may, however, be utilised to finance a private loan to a shareholder, which will not necessarily be considered to be incurred in the course of a trade."*

It seems clear from the above, that the term 'in the course of a trade' is broader than 'in the ordinary course of a trade' and that the former will not only include routine transactions but will also include isolated or non-recurrent transactions such as the acquisition or disposal of capital assets.

The terminology used in the definition of 'input tax' in the VAT Act is not restricted to goods or services acquired for the purposes of being used in the ordinary course of making taxable supplies. It is, however, narrower in the sense that it does not simply include any trade-related expenditure. The business may make both taxable and exempt supplies and the expenditure incurred must relate to, or be incurred in the process of making taxable supplies.

It is apparent from the terminology used that the goods or services acquired do not, in turn, have to be on-supplied as taxable supplies. They may be 'used or consumed' in the course of making taxable supplies. In other words, they may form part of the overhead structure or cost of making taxable supplies.

However, is the phrase 'in the course of making taxable supplies' broad enough to include expenditure which will initially generate exempt supplies, the proceeds from which will be used to generate taxable supplies? If one can consider that a direct link can be satisfied by a functional link then a close linear link is not required. In other words, the question is not whether there is a direct and immediate link between the services used and the taxable supply, but whether there is a sufficiently close relationship with the enterprise in the course of which the taxable supplies are made.

Carmen Holdstock

RESIDENCY STATUS OF A NON-RESIDENT WHO APPLIES FOR A TEMPORARY RESIDENCE PERMIT

On 30 August 2013 the South African Revenue Service (SARS) issued Binding Private Ruling 153, which dealt with the residency status of a non-resident natural person who intends applying for a temporary residence permit in South Africa.

The applicant was contemplating moving to South Africa as he had recently retired and had been spending extended periods of time in the country. The question posed was whether the granting of a retired person's permit (RPP) for temporary residence, would result in the applicant becoming ordinarily resident in South Africa for tax purposes.

The Department of Home Affairs prescribes that RPP's may be issued to persons who wish to retire in South Africa, provided that such persons comply with the financial requirements provided for in the Immigration Act, No 13 of 2002 (IA) and its regulations.

Section 20 of the IA requires that a person applying for an RPP must provide proof of a right to a pension or irrevocable annuity for the remainder of their life, as well as proof that the applicant has the minimum prescribed net worth.

In this instance, SARS ruled, on the assumption that the applicant is not a 'resident' for purposes of s1(1) of the Income Tax Act, No 58 of 1962, that an application for an RPP will not, in itself, be sufficient for the applicant to become ordinarily resident in South Africa. This was made subject to the applicant not indicating an intention to the Department of Home Affairs to settle in South Africa on a permanent basis.

According to the IA, an RPP is valid for a period not exceeding four years and may subsequently be renewed one or more times.

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