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TAX AND EXCHANGE CONTROL ALERT

IN THIS **ISSUE**

CDH
CLIFFE DEKKER HOFMEYR

VALUE-ADDED TAX ON THE SUPPLY OF STUDENT ACCOMMODATION

Under the Value-Added Tax Act, No 89 of 1991 (Act) the supply of a "dwelling under an agreement for the letting and hiring thereof" is exempt from VAT.

Is the owner supplying residential accommodation (dwellings) to students, in which case it must charge no VAT on rentals, or is the owner supplying commercial accommodation, in which case it must charge VAT?

For some time now there has been a shortage of accommodation for tertiary students in South Africa. Developers have seen the gap in the market and have started building apartment buildings to provide housing to students.

The typical arrangement works as follows: The owner of the building rents individual apartments to the students for a period of 10 months a year. The apartments come with beds and tables. There is a communal kitchen, a laundry facility, and a lounge area with a TV and Wi-Fi.

Sometimes the owners let the buildings to tertiary institutions who, in turn, let the apartments to the students.

How should owners account for value-added tax (VAT) on the rent they charge for the supply of the accommodation?

Unfortunately, that is a difficult question to answer.

Under the Value-Added Tax Act, No 89 of 1991 (Act) the supply of a "dwelling under an agreement for the letting and hiring thereof" is exempt from VAT. So, a person letting a dwelling to a tenant must not charge VAT on the rental, and is not able to claim input tax on the supplies to it, notably, the cost of acquiring or constructing the dwelling.

The term "dwelling" is defined to mean "except where it is used in the supply of commercial accommodation, any building, premises, structure, or any other place or part thereof, used predominantly as an abode of any natural person or which is intended for use predominantly as a place of residence or abode of any natural person, including fixtures and fittings belonging thereto and enjoyed therewith".

"Commercial accommodation" is defined, to the extent that it is relevant, as "lodging or board and lodging, together with domestic goods and services, in any house, flat, apartment, room, hotel, motel, inn, guest house, boarding house, residential establishment, holiday accommodation...or similar establishment, which is regularly or systematically supplied but excluding a dwelling supplied in terms of an agreement for the letting and hiring thereof".

"Domestic goods and services" are "goods and services provided in any enterprise supplying commercial accommodation, including...cleaning and maintenance... electricity, gas, air conditioning or heating...a telephone, television set, radio or other similar article...furniture and other fittings...meals...laundry...or...water."

The supply of commercial accommodation is not VAT exempt.

In the typical arrangement described above, is the owner supplying residential accommodation (dwellings) to students, in which case it must charge no VAT on rentals, or is the owner supplying commercial accommodation, in which case it must charge VAT?

The answer to that question has a significant commercial impact: if the rental is subject to VAT, then students must pay an additional amount for their accommodation, unless the owner absorbs the amount of VAT.

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In my opinion, where owners rent apartments to students for longer periods (for example 10 months) together with furniture, utilities, laundries and communal areas, for an all-inclusive rent, it is more likely that the supply will be exempt from VAT.

At first blush it appears as if the owners are supplying commercial accommodation to the students. After all, the owners appear to be providing "lodging" together with goods and services like cleaning, electricity, TV sets, water, and laundry facilities.

However, the provision in the VAT Act relating to the exemption of the letting of a "dwelling" contemplates that the supply may be exempt even if it is supplied with "fixtures and fittings belonging thereto and enjoyed therewith".

So, in my view, the fact that the student apartments are provided with certain amenities is not decisive. (Compare the following statement at page 12 of the guide of the South African Revenue Service (SARS) titled *VAT 411 – Guide for Entertainment, Accommodation and Catering* (SARS Guide):

> The supply of furnishings and fittings is not usually a reliable indicator of whether the supply should be characterised as a dwelling or commercial accommodation. Commercial accommodation is almost always supplied together with the use of furniture and fittings and access to certain facilities and amenities, but these could also be supplied together with a dwelling under the lease agreement, for a fully or partially furnished dwelling.

The real issue is whether or not the agreements under which apartments rented to students are "agreements for the letting and hiring" of a dwelling, in other words, whether or not the agreements constitute lease agreements, in ordinary parlance – as distinct from, on the other hand, commercial accommodation which "involves making available the use of an accommodation unit which forms part of the assets or resources of the accommodation establishment to the guest under a general agreement, understanding, or licence to occupy" (SARS Guide at page 12).

In my opinion, where owners rent apartments to students for longer periods (for example 10 months) together with furniture, utilities, laundries and communal areas, for an all-inclusive rent, it is more likely that the supply will be exempt from VAT.

However, I recognise that there is a fine line between the supply of a dwelling under a lease and the supply of commercial accommodation, and that each arrangement should be considered on the relevant facts.

In the case of *Respublica (Pty) Ltd v C: SARS* case number 864/2014 the taxpayer concluded a five year lease agreement with a university. The property was let for the sole purpose of accommodating the university's students. The property was divided into smaller units which were furnished with a kitchenette, bathroom and bedroom/living area. The taxpayer supplied water and electricity, maintenance costs, management of the building, a common TV room and laundry services.

The university paid the taxpayer monthly rental. The rental included an amount for utilities. The taxpayer sought guidance from the court on the manner in which it should account for VAT. (Notably, the

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Ideally, the Legislature should amend the Act to make it clear how the supply of student accommodation should be treated for VAT purposes.

taxpayer sought an order to the effect that its supply to the university was one of "commercial accommodation", and that it accordingly was liable to account for VAT at the relevant rate on the rental. The taxpayer did not seek an order to the effect that the supply to the university was that of residential accommodation.)

The court held that the word "lodging" in the definition of "commercial accommodation" should be given a wide meaning under the Act and that the term should be read in conjunction with the purpose for which the property was let to the university, that is, for the purpose of accommodating students. The court accordingly held that, despite the fact that the university itself could not, and did not lodge in the building, the letting of the accommodation by the taxpayer to the university constituted the supply of "commercial accommodation" under the Act.

For a full discussion of the case see our *Tax and Exchange Control Alert* of 18 March 2016.

In my view, that judgment is not support for the view that the supply of all student accommodation with amenities should be treated as "commercial accommodation". The court did not consider at all whether or not the supply could have been that of a dwelling under a lease.

The *Respublica* case is, however, support for the position that if an owner of an apartment building leases the building to the university, and the university then sub-leases the apartments to students as a dwelling under a lease agreement, the supply of the building to the university will also be the supply of a dwelling under a lease agreement and, accordingly, exempt from VAT.

Finally, there is an important policy consideration which I alluded to above. The reason why the letting of residential accommodation is exempt from VAT is mainly because a VAT system should not discriminate against people who rent their residences, as opposed to owning their own residence where owning a residence is an exempt supply (see du Preez, H and Klein, AE *The value-added tax implications of the temporary change in use adjustments by residential property developers: an international comparative study* at page 61). That consideration is even more pertinent where the tenants are students who, by virtue of the high cost of tertiary education, will no doubt in the overwhelming number of cases have less means than "ordinary" tenants to pay VAT if it were levied on rental for student accommodation.

Ideally, the Legislature should amend the Act to make it clear how the supply of student accommodation should be treated for VAT purposes.

Ben Strauss

GREEN, GREENER, GREENEST – A RULING ON SECTION 12K OF THE INCOME TAX ACT

On 9 June 2016, the South African Revenue Service (SARS) issued Binding Class Ruling 053 (Ruling), which deals with the application of s12K of the Act in the context of a Clean Development Mechanism (CDM) project.

The recent announcement by Eskom that it would reconsider its position on the use of renewable energy has caught the attention of many in the renewable energy industry. The Income Tax Act, No 58 of 1962 (Act) contains a number of tax incentives which are available to participants in the renewable energy industry, including the exemption of certified emission reductions (CERs), contained in s12K of the Act.

The CPA owners intend to produce CER credits under the CPA which will be sold to industrialised countries, in terms of emission reduction purchase agreements.

On 9 June 2016, the South African Revenue Service (SARS) issued Binding Class Ruling 053 (Ruling), which deals with the application of s12K of the Act in the context of a Clean Development Mechanism (CDM) project. The parties to the Ruling are a non-profit association of green energy producers (Applicant), the project developer and sponsor of the registration of the CDM project with the Executive Board of the United Nations Framework Convention on Climate Change (UNFCCC) (Project Developer) and the owners of the CDM projects registered under the programme of activities (CPA owners).

Facts

The Applicant is a non-profit organisation which aims to raise awareness and facilitate the transition to a climate resilient society within South Africa. It achieves its objectives through, amongst other things, providing an independent platform for the hosting of programmes of activities (CPAs) for CDM projects registered under the Kyoto Protocol and acts as the coordinating and management entity for these CPAs. The Applicant and the Project Developer, who is also a CPA owner, have established a CDM project in a programmatic form, contemplated in Article 12 of the Kyoto Protocol, which is registered with the CDM Executive Board. The CPA owners intend to produce CER credits under the CPA which will be sold to industrialised countries, in terms of emission reduction purchase agreements. The relationship between the parties will be governed by a CPA agreement which states, amongst other things, the following:

- The CPA is to be registered with the CDM executive board together with the first CDM project undertaken by the Project Developer. Other potential CPA owners who wish to participate in the CPA will be invited to do so upon payment of an inclusion fee and will be added by way of supplemental deeds of inclusion to the CPA as provided for by the CDM rules.
- The Applicant will do a number of things, including acting as the coordinating and management entity for the CPA and managing the CER credits sales process and collecting the revenue (carbon revenue) in its capacity as manager of the CPA on behalf of the CPA owners. It will receive a fee for services rendered as manager of the CPA.

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The South African government recognised that climate change requires a considered international and domestic policy response and as part of South Africa's domestic policy response to climate change, tax relief in the form of s12K was introduced to overcome the market failure associated with environmental protection.

- The Project Developer will fund the development phase budget to establish the CPA. All CPA owners will pay an annual fee to cover expenses of the CPA.
- The CER credits generated by the CPA will be jointly owned by the Project Developer and the CPA owners on the basis that ownership of a certain specified percentage of the gross CER credits will accrue to the Project Developer as the project sponsor and the balance will be jointly owned by all CPA owners and accrue to each CPA proportionally according to its contribution of CER credits in the relevant period.
- The Applicant will pay all the expenses related to the running of the CPA from the inclusion fees, annual fees and carbon revenue, if required, and will distribute the surplus to the CPA owners according to their proportional share of revenue calculated based on the CER credits contributed in the relevant period.

Background to section 12K

Section 12K of the Act came into effect on 11 February 2009 and according to the Explanatory Memorandum on the Taxation Laws Amendment Bill, 2009 (2009 Explanatory Memorandum) the reason for this was the limited uptake of CDM projects within South Africa. The 2009 Explanatory Memorandum states that CDM was created by the Kyoto Protocol as a mechanism to ensure that developed countries can meet their carbon emission reduction targets, while also ensuring that developing countries can participate in a global reduction market. In this regard, the Kyoto Protocol makes it possible for CDM projects to yield CERs which are technically saleable to and usable only by developed countries.

According to the 2009 Explanatory Memorandum, the limited uptake of CDM projects within South Africa stems from the high financial (and bankable) hurdle rates due to the risks associated with CDM project activities (CPAs). Financial hurdle rates include, amongst other things, the high cost involved in financing CPAs. The South African government recognised that climate change requires a considered international and domestic policy response and as part of South Africa's domestic policy response to climate change, tax relief in the form of s12K was introduced to overcome the market failure associated with environmental protection.

The provisions of section 12K

Section 12K(2) states that any amount received by or accrued to or in favour of any person in respect of the disposal by that person of any CER derived by that person in the furtherance of a qualifying CDM project carried on by that person. Section 12K(1) states that for a CDM project to constitute a "qualifying CDM project", the designated national authority (DNA) must issue a letter of approval as contemplated in the Regulations establishing the DNA. Secondly, the CDM project must be registered in terms of the modalities and procedures for a clean development mechanism as defined in Article 12 of the Kyoto Protocol.

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As the Draft Regulations to the Draft Carbon Tax Bill currently stand, it appears that it might be possible for carbon credits generated by a "qualifying CDM project" in terms of s12K, to be used by a taxpayer to receive an offset allowance in terms of the Draft Carbon Tax Bill.

Ruling

SARS ruled that:

- The CPA will be a "qualifying CDM project" as defined in s12K(1) of the Act.
- The CPA owners and the first CDM project owner will be the persons carrying on the "qualifying CDM project".
- The carbon revenue generated by the CPA will be exempt from income tax under s12K(2) of the Act in the hands of the CPA owners. The exemption is not affected by the fact that the carbon revenue will be received by the Applicant acting in its capacity as manager of the CPA.
- Only carbon revenue from the CER credits that the first CDM project owner derives from conducting its own CDM project of activities will qualify for exemption under s12K(2) of the Act and the carbon revenue from the disposal of the extra CER credits accrued in terms of the CPA agreement will not be exempt from normal tax under s12K(2) of the Act.
- The CER credits need not be accounted for as "trading stock" as defined in s1(1) of the Act.
- The sale of CER credits to non-resident purchasers will be subject to VAT at a zero rate under s11(2)(l) of the VAT Act, No 89 of 1991 provided all the requirements of that section are complied with.

Comment

It should be noted that in terms of the current Draft Regulations to the Draft Carbon Tax Bill, a CDM project, similar to the one discussed in the Ruling, can generate carbon offsets. The carbon credits generated by such project will have to be surrendered to SARS to make use of the carbon offset allowance. As the Draft Regulations to the Draft Carbon Tax Bill currently stand, it appears that it might be possible for carbon credits generated by a "qualifying CDM project" in terms of s12K, to be used by a taxpayer to receive an offset allowance in terms of the Draft Carbon Tax Bill. However, we will only have clarity once the legislation regarding carbon tax has been finalised.

Louis Botha

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CUSTOMS AND EXCISE HIGHLIGHTS

Please note that this is not intended to be a comprehensive study or list of the amendments, changes and the like in the Customs and Excise environment, but merely selected highlights which may be of interest.

In the event that specific advice is required, kindly contact our Customs and Excise specialist, Director, Petr Erasmus.

Below are selected highlights in the Customs & Excise environment since our last instalment.

1. Amendment of Schedule 2 (anti-dumping duty) relating to Bolts & Nuts – deletion of 3 items.
2. Draft amendment of Schedule 1 Part 1 to insert new provisions for vegetable oils marketed and supplied for use in cooking food. Explanatory summary as follows:

   The supply of vegetable oils (excluding olive oil) under section 11(1)(j) read with Item 14 in Part B of Schedule 2 to the VAT Act is zero-rated, provided the vegetable oils is marketed and supplied for use in the process of cooking food. These are also VAT exempt when imported under section 13(3) read with paragraph 7 of Schedule 1 to the VAT Act. The tariff amendment is required to align the relevant provisions in Schedule No.1 Part 1 of the Customs and Excise Act to those of the VAT Act.

   Due date for comments: 25 August 2016; send comments to: AMpanza@sars.gov.za.
3. Draft Rule Amendment by the insertion of Rule 49E relating to the preferential trade agreement between the Common Market of the South (MERCOSUR) and the South African Customs Union (SACU). Draft amendment of application forms also included. Explanatory Note as follows:

   In December 2004, the Common Market of the South (MERCOSUR), comprising Argentina, Brazil, Paraguay and Uruguay, and the South African Customs Union (SACU), comprising Botswana, Lesotho, Namibia, South Africa and Swaziland signed a preferential trade agreement aimed at promoting trade between MERCOSUR and SACU on a select number of products. Rules in terms of the Customs and Excise Act, 1964 have been drafted to give effect to Annex III of the trade agreement.

   Due date for comments: 29 August 2016; send comments to: C&E_legislativecomments@sars.gov.za.
4. Draft Rule Amendment by the amendment of the time reflected in Rule 101A.12 when any tariff heading or item of any Schedule is amended. Explanatory Note:

   Amendment of the "15:00 rule" regarding the electronic submission of clearance declarations when any tariff heading or item of any Schedule has been amended.

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CUSTOMS AND EXCISE HIGHLIGHTS

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The Davis Tax Committee recommends that the functions and powers of SARS and the BMA be kept separate and that the Agency should not be assigned any of the current functions and powers of SARS with regard to revenue (taxes and customs and excise) collection and the control of goods that is associated with such collection functions.

Due date for comments: 30 August 2016; send comments to: C&E_legislativecomments@sars.gov.za.

5. The Davis Tax Committee (DTC) has published its comments in relation to the Border Management Agency Bill, 2015 on its website (www.taxcom.org.za).

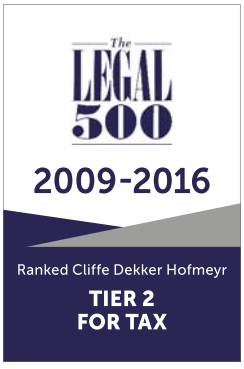
   The Bill provides for:

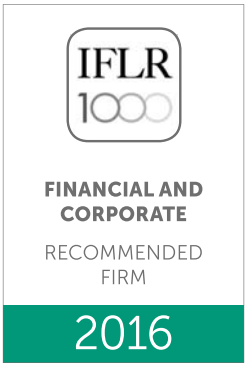
   > The establishment, organisation, regulation, functions and control of the Border Management Authority; to provide for the appointment, terms of office, conditions of service and functions of the Commissioner; to provide for the appointment and terms and conditions of employment of officials; to provide for the duties, functions and powers of officers; to provide for the establishment of an Inter-Ministerial Consultative Committee, Border Technical Committee and advisory committees; to provide for delegations; to provide for the review or appeal of decisions of officers; to provide for certain offences and penalties; to provide for the Minister to make regulations with regard to certain matters; and to provide for matters connected therewith.

   In its comments, the DTC concludes as follows:

   > Based on the above, the Davis Tax Committee recommends that the functions and powers of SARS and the BMA be kept separate and that the Agency should not be assigned any of the current functions and powers of SARS with regard to revenue (taxes and customs and excise) collection and the control of goods that is associated with such collection functions. Of particular concern is the extraordinarily poor timing of the Bill. According to the 2014 Tax Statistics issued by SARS, the total of customs duties, import VAT, and ad valorem import duties collected amounted to R176.9 billion for the 2013-14 fiscal year. This was approximately 19% of the total revenue collected.

Petr Erasmus





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BBBEE STATUS: LEVEL THREE CONTRIBUTOR
Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 3 BBBEE verification under the new BBBEE Codes of Good Practice. 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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