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TAX & EXCHANGE CONTROL **ALERT**

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Splitting hairs... VAT Case 1558

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Customs & Excise Highlights

This week's selected highlights in the Customs & Excise environment since our last instalment.

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Splitting hairs... VAT Case 1558

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Suppliers often make single supplies of goods or services to their customers which comprise of various component parts such as, for example, various goods purchased in a supermarket, some of which are subject to VAT at the standard rate and some of which are zero rated. Other examples include tour operators who charge a single fee for a tour package which may comprise of standard rated accommodation and zero-rated international travel, or an insurer who charges a single premium for providing insurance cover for assets located in South Africa and offshore.

Section 8(15) of the Value-Added Tax Act, No 89 of 1991 (VAT Act) prescribes how VAT should be levied on these supplies. Section 8(15) provides that if a single supply of goods or services, or of goods and services is made, and if separate considerations had been payable, they would have been charged for in part at the standard rate and in part at the zero-rate, then each part of the supply is deemed to be a separate supply for VAT purposes. This means that the supplier only levies VAT at the standard rate on that part of the consideration of the composite supply which is attributable to the standard rated goods or services. The zero rate applies to the part of the consideration which is attributable to the zero-rated goods or services supplied.

The application of s8(15) of the VAT Act was recently considered by the Tax Court in the case of *Taxpayer v The Commissioner for the South African Revenue Service* (VAT1558) [2018] ZATC 3 (5 December 2018) with regard to its application to marketing services.

The facts

In this case the taxpayer manufactured and distributed various brands of alcoholic beverages in South Africa under an exclusive rights distribution agreement entered into with foreign brand owners. The taxpayer supplied marketing services to the foreign brand owners for a fee. The marketing fee was calculated with reference to the actual annual cost the taxpayer incurred on marketing the brands. The marketing included a mix of media advertising, promotions, sponsorships, and relationship marketing. It also included product sampling and tasting, product giveaways comprising of, *inter alia*, branded glassware, t-shirts and lanyards to raise brand awareness. The products used for product sampling and tasting were taken out of the taxpayer's own stock and the taxpayer paid for the promotional goods purchased for marketing purposes. The taxpayer charged a single all-inclusive marketing fee to the foreign brand owners and levied VAT thereon at the rate of zero per cent. SARS levied VAT at the standard rate in terms of s8(15) on the portion of the fees which was calculated on the cost of the promotional goods incurred by the taxpayer.

The arguments

SARS argued that the portion of the marketing fee which is attributable to the promotional goods is subject to VAT at the standard rate in terms of s8(15) because the cost of such goods can be determined, they were supplied and consumed locally and were not exported.

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Splitting hairs... VAT Case 1558*...continued*

The taxpayer argued further that it supplied a single marketing service to the foreign brand owners and did not make any separate supply of goods to the foreign brand owners.

The taxpayer argued that it had a contractual obligation to supply the marketing services, and that the distribution of promotional materials and stock tasting, although not obligatory, was undertaken not as an aim in itself, but as part of the advertising strategy employed by the taxpayer in rendering the marketing services. The foreign brand owners did not require the taxpayer to distribute promotional items or to arrange product tasting events. These were part of the marketing strategy applied by the taxpayer. The taxpayer argued further that it supplied a single marketing service to the foreign brand owners and did not make any separate supply of goods to the foreign brand owners.

The Judgment

In considering the application of s8(15) of the VAT Act, the court held that s8(15) is concerned with the notional separation of supplies if separate considerations had been payable. The court held that the determination for purposes of s8(15) of the VAT Act of whether separate considerations are notionally payable does require the economic nature and commercial reality of the transaction to be considered. The court held that there is, however, no requirement that any notional separation should avoid what may be considered to be an artificial dissection of a transaction if cognizable goods or services for which separate considerations could have been payable can be identified. The court stated that the cost of supplying the promotional goods was readily ascertainable. It did not matter that the promotional goods were not received or consumed by the foreign brand owners. The court found that the supply of the promotional goods was capable of notional separation and was accordingly deemed to be a separate supply in terms of s8(15) of the VAT Act. The portion of the marketing fee which was calculated based on the cost of the promotional goods was therefore held to be subject to VAT at the standard rate.

The implications

The judgment may have far-reaching implications for suppliers, particularly if s8(15) requires a notional separation of supplies if separate considerations had been payable, and if such notional separation does not need to avoid an artificial dissection of a transaction, as held by the Tax Court. For example, where a product containing a mixture of maize meal and wheat bran is sold, on the basis that the quantity or volume of the maize meal and the wheat bran is readily ascertainable and can be notionally separated, and that it is possible to determine the cost of each supply, it seems that in terms of the judgment in VAT Case 1558 the maize meal component should be zero rated and the wheat bran component should be subject to VAT at the standard rate.

The implications of the judgment are also evident if one considers SARS Binding General Ruling (VAT) No.38 (BGR38) regarding the VAT treatment of vegetables

Splitting hairs... VAT Case 1558*...continued*

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and fruit. The supply of unprocessed fruit and vegetables is subject to VAT at the zero rate. BGR38 provides that where any substance is added to the vegetables or fruit, whether or not separately packed in the same container, the zero rate will not apply. For example, where garlic butter is added to raw baby potatoes and they are sold as a single product in the same packaging, the zero rate does not apply due to the standard rated substance added thereto. However, if the judgment in VAT Case 1558 is applied, on the basis that one can identify two cognisable supplies which are capable of notional separation, namely the vegetables and the butter, and that one can determine the cost of the vegetables and that of the butter, only that part of the price which is attributable to the butter will be subject to VAT at the standard rate.

The judgment in VAT Case 1558 seems to contradict the judgment of the Supreme Court of Appeal (SCA) in the case of Commissioner for the *South African Revenue Service v British Airways plc* 2005 (4) SA 231 (SCA). The Tax Court appears to have distinguished this case from the British Airways case on the basis that in the British Airways case two vendors supplied distinct services. However, the SCA held that British Airways supplied a single international transport service and incurred the cost of passenger services provided by another supplier for its own account, and British Airways merely recovered such cost from its passengers as part of the consideration for supplying the international travel service. The SCA also stated that s8(15) does no more than apportion the rate at which the vendor is required to pay the VAT levied by s7, when the vendor has supplied different goods or services as a composite whole. According to the SCA, s8(15) does not seem to require an artificial dissection of a single supply of a single product or service, but it applies when a single supply comprises of different components, therefore to supplies such as those made by a supermarket, a tour package compiled by a tour operator or insurance cover provided for goods located locally and offshore.

We understand that the taxpayer in this case has applied for leave to appeal the judgment. Hopefully the appeal court will provide clarity regarding the application of s8(15).

Varusha Moodaley and Gerhard Badenhorst

Customs & Excise Highlights

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

This week's selected highlights in the Customs & Excise environment since our last instalment.

1. Amendments to Rules to the Customs & Excise Act No. 91 of 1964 (Act) (certain sections quoted from the SARS website):

   1.1 Amendment to Rule 8 to the Act in relation to part-shipments.

   1.2 Draft rule amendment – insertion of Rules. The insertion of draft rule 107A aims to ensure control of the supply chain in the tobacco industry. The rule provides requirements in respect of tobacco leaf threshers. Tobacco leaf threshers are required to register their factories with the Commissioner and keep records for purposes of inspection by the Commissioner. Draft forms are also intended to be amended/inserted, as follows:

      1.2.1 DA 185: Application form: Registration / licensing of customs and excise clients; and

      1.2.2 DA 185.4A1: Application form (client Type 4A17) – Registered leaf threshing factory.

      Comments may be submitted to: C&E_legislativecomments@sars.gov.za by 28 June 2019.

2. Amendments to Schedules to the Act (certain sections taken from the SARS website):

   2.1 Schedule 1 Part 1:

      2.1.1 The substitution of tariff headings 8471.30.10, 8471.41.10 and 8471.49.10 to clarify the scope of computers that are subject to payment of ad valorem excise duties (with retrospective effect from 1 April 2019);

      2.1.2 The substitution of tariff subheadings 1001.91 and 1001.99 as well as 1101.00.10 and 1101.00.90 to increase the rate of customs duty on wheat and wheaten flour from 49,07c/kg and 73,61c/kg to 67,51c/kg and 101,26c/kg respectively, in terms of the existing variable tariff formula; and

      2.1.3 The deletion of tariff heading 6210.10.20 and the insertion of tariff heading 6210.10.50 in order to review the description from "disposable panties" to "disposable underwear" as well as increase the rate of customs duty from free to 40%;

   2.2 Schedule 1 Part 2B:

      2.2.1 The substitution of tariff items 124.11.01, 124.11.05 and 124.11.09 to clarify the scope of computers that are subject to payment of ad valorem excise duties (with retrospective effect from 1 April 2019);

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Customs & Excise Highlights...*continued*

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2.3 Schedule 1 Part 5A:

2.3.1 To give effect to the budget proposal to implement the carbon fuel tax on fuel as announced by the Minister of Finance on 20 February 2019 (with effect from 5 June 2019);

2.4 Schedule 2:

2.4.1 Subjection of imports from Chinese Taipei (Taiwan) to the payment of safeguard duties on certain flat hot-rolled steel products (with effect from 24 May 2019 up to and including 10 August 2019); and

2.4.2 Amendment of Schedule 2 in order to subject imports from Chinese Taipei (Taiwan) to the payment of safeguard duties on certain flat hot-rolled steel products (with effect from 11 August 2019 up to and including 10 August 2020);

2.5 Schedule 4:

2.5.1 The insertion of rebate items 460.15/7604.29.15/01.08 and 460.15/7604.29.65 in order to create a temporary rebate provision for aluminium bars, rods and profiles for use in the manufacture of stabilisation fins; and

2.6 Schedule 6:

2.6.1 To exclude the carbon fuel tax as announced by the Minister of Finance on 20 February 2019 from the diesel refund scheme (with effect from 5 June 2019).

3. SARS issued a media release on 31 May 2019 in relation to trade statistics for April 2019 recording a trade deficit of R3.43 billion. These statistics include trade data with Botswana, Eswatini, Lesotho and Namibia (BELN).

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Customs & Excise Highlights...*continued*

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4. The International Trade Administration Commission has (certain sections quoted from the notice):

   4.1 Issued a notice to the effect that anti-dumping duty on certain products will expire on certain dates. The Commission notified all interested parties that, unless a duly substantiated request is made by or on behalf of the Southern African Customs Union (SACU) industry, indicating that the expiry of the duty would likely to lead to continuation or recurrence of dumping and injury, the following anti-dumping duties will expire during 2020. The due dates for submissions are also provided as follows:

	PRODUCT	COUNTRY	DATE OF EXPIRY OF DUTY	DATE OF SUBMISSION
1	Garlic	PRC	29/10/20	30/04/20
2	Stainless steel sinks	PRC, Malaysia	30/7/20	21/01/20
3	Wheelbarrows	PRC	03/09/20	04/03/20
4	Float and flat glass	PRC, India	20/07/20	31/01/20
5	Frozen bone - in chicken portions	Germany, Netherlands, UK	26/02/20	27/08/19
6	Cement	Pakistan	17/12/20	18/06/20

   The requests by manufacturers in the SACU of the subject products, and the duly substantiated information indicating what the effect of the expiry of the duties will be, must be submitted in writing to the following addresses:

   4.1.1 The Senior Manager: Trade Remedies I International Trade Administration Commission - The DTI Campus, 77 Meintjies Street, Block E – Uuzaji Building, Sunnyside, Pretoria

   4.1.2 Private Bag X753, Pretoria, 0001

   Manufacturers in the SACU of the subject products listed above, who wish to submit a request for the duty to be reviewed prior to the expiry thereof, are requested to do so not later than close of business on 24 June 2019.

5. The National Regulator for Compulsory Specifications has released its "NRCS ONLINE LOA PROCEDURE AND POLICY – 2019". It includes *inter alia* administrative procedures, policy documents and fee structures.

6. Please advise if additional information is required.

Petr Erasmus

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BBBEE STATUS: LEVEL ONE CONTRIBUTOR

Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 1 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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