



18 MAY 2023

Tax & Exchange Control ALERT

IN THIS ISSUE

Concept clarification: Zero-rated vs exempt supplies

"Confused? Confusion is good. It's an excellent place to learn something new from." – Henna Inam



FOR MORE
INSIGHT INTO
OUR EXPERTISE
AND SERVICES



CLIFFE DEKKER HOFMEYR

INCORPORATING
KIETI LAW LLP, KENYA

Concept clarification: Zero-rated vs exempt supplies

"Confused? Confusion is good. It's an excellent place to learn something new from."
– **Henna Inam**

Although seemingly simple, the value-added tax (VAT) concept of zero-rated supplies vs exempt supplies is often confused and misused. The importance of distinguishing between these concepts is, however, crucial for purposes of determining the VAT liability of a vendor as well as a vendor's entitlement to claim input tax deductions in respect of expenses incurred. The distinction between these concepts as well as the importance behind the distinction is unpacked below.

Nature of supplies

VAT is often referred to as a tax on the consumption of goods or services and is levied on the supply by a vendor of goods or services in the course and furtherance of any enterprise carried on by a vendor.

For VAT purposes all supplies are treated as either being standard rated, zero-rated, or exempt. Supplies that are standard rated or zero-rated are "taxable supplies" as defined.

Standard rated supplies are supplies that are subject to VAT at the prescribed rate of 15%. The supply of goods and services is generally subject to VAT at the standard rate unless such supply is specifically zero-rated or exempt in terms of the Value-Added Tax Act 89 of 1991 (VAT Act).

A zero-rated supply is a taxable supply on which VAT is levied at the rate of 0%. That is, even though the supply has been classified as being a taxable supply, VAT is only chargeable thereon at the rate of 0%. This means that even though no VAT is levied on a supply, and as such, that no output tax will be payable to the South African Revenue Service (SARS) in respect of zero-rated supplies, it is still considered to form part of a vendor's enterprise activities.

Zero-rating is only granted to specific transactions that serve certain objectives considered more significant by the Government than collecting



The graphic features a gold diagonal stripe across a light blue background. At the top left, it displays 'The LEGAL 500 EMEA' logo. Below this, the text reads: 'Tax 2023 Rankings', 'Tax & Exchange control practice is ranked in Tier 1.', 'Leading Individuals: Gerhard Badenhorst | Emil Brincker', 'Recommended Lawyers: Petr Erasmus | Mark Linington Howmera Parak Ludwig Smith Stephan Spamer', and 'Next Generation Lawyers: Jerome Brink'.

Concept clarification: Zero-rated vs exempt supplies

CONTINUED

additional VAT. Most transactions granted zero-rated status involve exporting goods or services, which is intended to promote exports and increase competitiveness globally.

Section 11 of the VAT Act sets out specific instances of supplies of goods and services that may be zero-rated. These include, for example, certain zero-rated foodstuffs, the exportation of goods, the sale of a business as a going concern, services supplied to non-residents who are not in South Africa, services physically rendered offshore, and certain international transport services.

An exempt supply is the supply of goods or services upon which neither VAT at the standard rate nor zero rate is chargeable. There is therefore no VAT levied on exempt supplies. An exempt supply is not a taxable supply and the term “enterprise” as defined in the VAT Act therefore specifically excludes the making of exempt supplies.

Supplies that constitute exempt supplies are specifically provided for in section 12 of the VAT Act. These include, for example, the supply of residential accommodation in a dwelling, certain forms of local passenger transport, certain educational services, childcare services, and financial services.

Most exemptions are justified on the basis that they are so-called merit goods, such as education. However, some goods are exempt because they are perceived to be hard to tax, for example, financial services. In the case of public transport in South Africa, the exemption was justified on the basis that compliance would be a major challenge, given the significant number of small informal taxi operators (The Davis Tax Committee: First Interim Report on VAT to The Minister of Finance (December 2014)).

Importance of distinction

It seems that the confusion that exists when distinguishing between zero-rated and exempt supplies stems from the fact that in both instances, no VAT is ultimately levied on such supplies made by vendors. In practice, when discussing the type of supplies made by a vendor, the terms are thus often used interchangeably as if they have the same meaning, without a clear understanding of the importance of the distinction.

An input tax deduction may be claimed when VAT is incurred on goods and services acquired for the purpose of consumption, use, or supply in the course of making **taxable supplies**. As discussed above, zero-rated supplies constitute “*taxable supplies*” as contemplated in the VAT Act, whereas exempt supplies are not taxable supplies. It follows that vendors making zero-rated supplies are entitled to claim their input tax deductions on goods or services acquired in the course of making such

Concept clarification: Zero-rated vs exempt supplies

CONTINUED

taxable supplies, whereas vendors may not claim an input tax deduction in respect of goods or services acquired in the course or furtherance of making exempt supplies. Furthermore, a person that makes only exempt supplies cannot register as a vendor as such person will not be seen to be carrying on an "enterprise" as defined.

The significance of zero-rating thus lies in the fact that a person who makes zero-rated supplies is required to charge 0% VAT, i.e. no VAT, but may still register as a vendor and claim full input tax credits on all goods and services acquired, in the same way as a vendor that charges tax at the standard rate. Zero-rating is thus the most advantageous type of VAT treatment and vendors making zero-rated supplies generally find themselves in a VAT refund position. As indicated above, persons making exempt supplies may not register as vendors and may not claim input tax

deductions in respect of expenses incurred. Furthermore, where a vendor makes mixed supplies, i.e. taxable, and exempt supplies, such vendor will be required to apportion its expenses incurred and may only claim input tax deductions to the extent that such expenses have been incurred for the purpose of making taxable standard or zero-rated supplies.

Takeaway

Zero-rated and exempt supplies are treated differently for VAT purposes and thus distinguishing between these concepts is important to ensure proper VAT treatment by a vendor.

A zero-rated supply is still subject to VAT, but the VAT rate is 0%.

A registered vendor may claim input tax deductions in respect of expenses incurred for the purposes of making zero-rated supplies, thus effectively enabling the vendor to recover the VAT incurred on its expenses.

On the other hand, an exempt supply is simply not subject to VAT. A supplier may therefore not claim any input tax deductions in respect of expenses incurred for purposes of making exempt supplies, and as such, must bear the cost of any VAT incurred on its expenses.

The difference between zero-rated and exempt supplies can significantly impact a business's cash flow and profitability. Businesses making zero-rated supplies may recover input tax, thus reducing their costs and increasing their profits, whereas businesses making exempt supplies cannot recover input tax, thus increasing their costs and reducing their profits. It is therefore important for businesses to understand the difference between zero-rated and exempt supplies and to accurately apply the correct VAT treatment to their supplies to avoid any potential penalties and to maximize their profitability.

Varusha Moodaley

OUR TEAM

For more information about our Tax & Exchange Control practice and services in South Africa and Kenya, please contact:



Emil Brincker

Practice Head & Director:
Tax & Exchange Control
T +27 (0)11 562 1063
E emil.brincker@cdhlegal.com



Dries Hoek

Director:
Tax & Exchange Control
T +27 (0)11 562 1425
E dries.hoek@cdhlegal.com



Louis Botha

Senior Associate:
Tax & Exchange Control
T +27 (0)11 562 1408
E louis.botha@cdhlegal.com



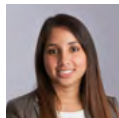
Sammy Ndolo

Managing Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E sammy.ndolo@cdhlegal.com



Alex Kanyi

Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E alex.kanyi@cdhlegal.com



Varusha Moodaley

Senior Associate:
Tax & Exchange Control
T +27 (0)21 481 6392
E varusha.moodaley@cdhlegal.com



Mark Linington

Director:
Tax & Exchange Control
T +27 (0)11 562 1667
E mark.linington@cdhlegal.com



Heinrich Louw

Director:
Tax & Exchange Control
T +27 (0)11 562 1187
E heinrich.louw@cdhlegal.com



Abednego Mutie

Senior Associate | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E abednego.mutie@cdhlegal.com



Gerhard Badenhorst

Director:
Tax & Exchange Control
T +27 (0)11 562 1870
E gerhard.badenhorst@cdhlegal.com



Howmera Parak

Director:
Tax & Exchange Control
T +27 (0)11 562 1467
E howmera.parak@cdhlegal.com



Nicholas Carroll

Associate:
Tax & Exchange Control
T +27 (0)21 481 6433
E nicholas.carroll@cdhlegal.com



Jerome Brink

Director:
Tax & Exchange Control
T +27 (0)11 562 1484
E jerome.brink@cdhlegal.com



Stephan Spamer

Director:
Tax & Exchange Control
T +27 (0)11 562 1294
E stephan.spamer@cdhlegal.com



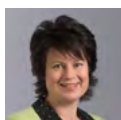
Puleng Mothabeng

Associate:
Tax & Exchange Control
T +27 (0)11 562 1355
E puleng.mothabeng@cdhlegal.com



Petr Erasmus

Director:
Tax & Exchange Control
T +27 (0)11 562 1450
E petr.erasmus@cdhlegal.com



Tersia van Schalkwyk

Tax Consultant:
Tax & Exchange Control
T +27 (0)21 481 6404
E tersia.vanschalkwyk@cdhlegal.com



Esther Ooko

Associate Designate:
Tax & Exchange Control
T +27 (0) 11 562 1778
E esther.ooko@cdhlegal.com

BBBEE STATUS: LEVEL ONE CONTRIBUTOR

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.

PLEASE NOTE

This information is published for general information purposes and is not intended to constitute legal advice. Specialist legal advice should always be sought in relation to any particular situation. Cliffe Dekker Hofmeyr will accept no responsibility for any actions taken or not taken on the basis of this publication.

JOHANNESBURG

1 Protea Place, Sandton, Johannesburg, 2196. Private Bag X40, Benmore, 2010, South Africa.

Dx 154 Randburg and Dx 42 Johannesburg.

T +27 (0)11 562 1000 F +27 (0)11 562 1111 E jhb@cdhlegal.com

CAPE TOWN

11 Buitengracht Street, Cape Town, 8001. PO Box 695, Cape Town, 8000, South Africa. Dx 5 Cape Town.

T +27 (0)21 481 6300 F +27 (0)21 481 6388 E ctn@cdhlegal.com

NAIROBI

Merchant Square, 3rd floor, Block D, Riverside Drive, Nairobi, Kenya. P.O. Box 22602-00505, Nairobi, Kenya.

T +254 731 086 649 | +254 204 409 918 | +254 710 560 114

E cdhkenya@cdhlegal.com

STELLENBOSCH

14 Louw Street, Stellenbosch Central, Stellenbosch, 7600.

T +27 (0)21 481 6400 E cdhstellenbosch@cdhlegal.com

©2023 12307/MAY