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Tax and Legal News

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Landmark case on retrospective approval of alternative VAT apportionment method

The 2011 amendment to section 17(1) of the VAT Act, 1991, dealing with the retrospective application of the approval by SARS of an alternative method of apportionment, has been the subject of great controversy until 15 November 2019, when the Tax Court (Case No: VAT2063) made a judgement on the matter. In essence, section 17(1) provides that vendors must use an apportionment method approved by the Commissioner. In this regard the only pre-approved method is the standard turnover-based method, as envisaged in Binding General Ruling 16 (BGR 16). This method determines the extent to which the VAT incurred on dual purpose expenses can be claimed as input tax, by expressing the total value of taxable supplies as a percentage of total receipts or accruals. Unlike most turnover-based methods used in other VAT/GST jurisdictions, the standard turnover-based method in BGR 16 includes income in respect of which no supplies have been made, such as dividend income, as well as passive income which requires no or insignificant usage of taxable resources, such as interest earned from a call account.

However, BGR 16 provides that a vendor may only use the standard turnover-based method, if the method is fair and reasonable failing which, the vendor must apply to SARS to use an alternative method, which is fair and reasonable. In this regard section 17(1)(iii) provides that where an apportionment method has been approved by the Commissioner, the method may only be changed from a future tax period, or from a date that the Commissioner may consider equitable, provided that such other date must fall, in the case of a vendor who is a taxpayer for income tax purposes, within the year of assessment during which the application for the alternative method has been made. In other words, if a vendor applies to the Commissioner for approval to use an alternative method, SARS may approve the method with retrospective effect, but at best from the first day of the financial year in which the application was made. For example, SARS may at best make the ruling effective from 1 March in relation to a vendor with a February year end who applies for an alternative apportionment method in December.

Some of the most common difficulties that occur, is that many vendors are blissfully unaware that they are required to apply an apportionment method approved by SARS, in order to determine the extent of VAT incurred on dual expenses (i.e. mostly overhead costs) should their non-taxable receipts and accruals, such as dividends, interest etc. represent more than 5% of total receipts or accruals. Another common mistake is that vendors apply a method which they believe is equitable, which may be based on floor space or head count etc., albeit that such methods have not been approved by SARS. By the time the vendors are made aware of the fact that they were required to use the standard turnover based method, it most often happens that the vendor has a five year retrospective VAT liability, including penalties and interest. In these circumstances the vendors often apply for the use of an alternative method, in which case the Commissioner generally approves the method with retrospective effect, but limited to the first day of the financial year in which the application was lodged, hence still leaving the vendor obligated to use the standard turnover basis for the period before the effective date of the ruling.

In these circumstances many vendors and their advisors have to date argued that since SARS has accepted that the standard turnover-based method does not yield equitable results, as is evident from the approval of an alternative method, SARS cannot raise assessments in respect of historic years where the vendor was required to use the standard turnover-based method.

These were the facts in the Tax Court case referred to above. In this case, Judge K M Savage (a Judge of the High Court) ruled that a sensible interpretation of section 17(1)(iii) is not one that would allow the taxpayer to have its ruling to use an alternative apportionment method applied retrospectively beyond the period envisaged

in that section. It is further stated that an interpretation that would serve to condone the taxpayer's tardiness in seeking a private ruling timeously in respect of historic years, strains the context and purpose of the section. The court further held that despite the fact that SARS approved an alternative method since the standard turnover-based method does not yield an equitable result, the provisions of section 17(1)(iii) expressly precluded the Commissioner from issuing a ruling that had an effect from an earlier date. The taxpayer was thus ordered to apply the standard turnover-basis of apportionment in respect of the years preceding the effective date of the ruling approving an alternative method.

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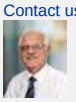

Andre Meyburgh
Director, Indirect VAT
Email: andre.meyburgh@kpmg.co.za
M: +27828516587

Erina Cooper
Director, Indirect VAT
Email: erina.cooper@kpmg.co.za
Ml: +27827195758

Anzuette Bezuidenhout
Associate Director, Indirect VAT
Email: anzuette.bezuidenhout@kpmg.co.za
Tel: +27827162690

Liezl Crause
Associate Director, Indirect VAT
Email: liezl.crause@kpmg.co.za
Tel: +27827195760

Regards
KPMG Tax & Legal
