31 May 2021

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

Matthew Besanko
Cape Town
+27 (0) 21 529 2027
m.besanko@pwc.com

Rodney Govender
Durban
+27 (0) 31 271 2082
rodney.govender@pwc.com

Juan Swanepoel
Johannesburg
+27 (0) 11 797 4747
juan.s.swanepoel@pwc.com

The exchange of currency and apportionment of input tax

In brief

On 25 May 2021, the Supreme Court of Appeal ('SCA') delivered judgment in the matter of the *Commissioner for the South African Revenue Services v Tourvest Financial Services (Pty) Ltd* (435/2020) [2021] ZASCA 61.

The judgment overturned the decision of the Tax Court in *ABC (Pty) Ltd v Commissioner for the South African Revenue Service (1626) [2020] ZATC,* which went in favour of the taxpayer.

At issue in both matters was the nature of the sale of foreign currency in return for a commission by Tourvest Financial Services (Pty) Ltd ('Tourvest') and its corresponding entitlement to input tax. In short, the SCA found that the sale of foreign currency constitutes an exempt activity and, as such, where a commission is charged, the activity does not lose its exempt nature and a mixed supply is created. The result of the SCA decision is that Tourvest was required to apportion its input tax.

In detail

Background

Tourvest's business comprises the buying and selling of currency to inbound and outbound travellers. It structured its business into three divisions: head office, treasury and a branch network, with each division having a separate operational function.

The treasury division is responsible for setting exchange rates for the buying and selling of foreign currencies to customers. The rate at which customers may buy and sell currency (inclusive of any margin) is displayed on a board in branches for customers.

The branches are responsible for the sale and exchange of foreign currencies to customers, and the head office provides a supporting role.

When a customer buys or sells currency, the relevant branch processes the transaction and charges the customer a commission or fee for its services.

For many years, Tourvest adopted the view that it made both taxable and exempt supplies and apportioned its input tax accordingly. Tourvest applied the standard turnover-based method of apportionment to determine the extent of input tax it was entitled to deduct for its business as a whole.

Subsequently, Tourvest reviewed its business and determined that it could directly attribute the VAT incurred by it to the respective business units/activities. Tourvest therefore adjusted its VAT returns to claim the portion of input tax that was previously not deducted in full by the branches on the basis that the branches made wholly taxable supplies.

SARS disagreed with this approach and insisted that the VAT in question be apportioned in accordance with the standard turnover-based method of apportionment. SARS accordingly issued an assessment. Tourvest appealed this assessment in the Tax Court.

The Tax Court upheld the appeal and confirmed that Tourvest should apply direct attribution to the expenses incurred by its branches that made wholly taxable supplies (as opposed to apportioning the VAT incurred). The Tax Court came to this decision on the basis of Tourvest's argument that the exchange of currency is a financial services activity. (However, in terms of a proviso to the definition of 'financial services', this activity is no longer deemed to be financial services where (or to the extent that) the consideration payable is a fee or commission).

SCA decision

The matter for consideration before the SCA was whether Tourvest, in conducting its enterprise of the exchange of currency through its branch network, made both taxable and exempt supplies, or, alternatively, whether it only made taxable supplies. In answering this question, the SCA considered the definitions of 'input tax', 'taxable supply', 'exempt supply', 'financial services' and 'consideration' per the VAT Act.

The critical definition in the SCA's analysis was the definition of 'financial services'. The SCA stated that the exchange of currency has been regarded as a financial service (and therefore an exempt supply) since the VAT Act was first introduced. The SCA further observed that, when the VAT Act was introduced, there was no proviso to the definition of 'financial services', which essentially took activities out of the financial services definition to the extent that the consideration payable in respect thereof constitutes any fee, commission or similar type of remuneration. The proviso was introduced later on (as a result of a recommendation by the Katz Commission to bring fee-based financial services into the VAT net.

The SCA confirmed that the sale of foreign currency constitutes an exempt activity, whether or not a fee/commission is charged, and found that the fact that a fee/commission is charged does not affect the nature of the activity of the exchange of currency (i.e. the activity does not lose its exempt nature). The Court went on to explain that the activity which, in the absence of the proviso, would have been an exempt financial service does not lose its exempt nature merely because it makes taxable supplies to the extent of the fee/commission. The Court concluded that, as a result of the wording of the proviso, a mixed supply is created.

The Court accordingly held that the exchange of currency remains an exempt financial service activity, and the proviso merely adds a taxable component to it. Input tax must therefore be apportioned and direct attribution of branch expenses is not possible.

The takeaway

The judgment reconfirms the working of the proviso to section 2(1), which plays an important role in the business of a vendor conducting financial services. Additionally the judgment reiterates the importance for a vendor to carefully consider and evaluate its input tax to ensure the correct attribution thereof as well the correct apportioning of amounts incurred for both taxable and non-taxable purposes take place.