

# Tax

# Alert

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## Value-added tax: Apportionment and direct attribution

### In brief

In *ABC (Pty) Ltd v CSARS (VAT 1626) [2020] SARSTC*, the Tax Court upheld an appeal by a vendor to apply direct attribution (as opposed to apportioning the VAT incurred by one of its divisions that made wholly taxable supplies).

### In detail

On 3 March 2020, the Tax Court issued its judgment in the matter of *ABC (Pty) Ltd v CSARS (VAT 1626) [2020] SARSTC*. This case concerned an appeal against a VAT assessment raised by SARS against the Appellant.

### Background

The Appellant's business involved the buying and selling of currency. As per the background outlined in the judgment, the Appellant structured its business into three divisions, being a 'Head Office', a 'Treasury' and a 'Branch Network', with each division having a separate operational function. The Treasury division was responsible for setting exchange rates for the buying and selling of foreign currencies to customers. The Branch network was responsible for the sale and exchange of foreign currencies to customers.

When a customer bought or sold currency, a branch within the Branch network would process the transaction and charge the customer a commission or fee for its services.

For many years the Appellant 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 (on the basis that it provided both taxable supplies and exempt supplies).

At some point, the Appellant reviewed its business and determined that it could directly attribute the VAT incurred by it to the respective/specific activities. The Appellant also determined that it could identify which divisions of its business were generating standard-rated supplies and exempt supplies. More specifically, the Appellant



identified that the VAT incurred by the branches was incurred wholly to make taxable supplies, and that the VAT incurred by the Treasury division was incurred wholly to make exempt supplies.

Accordingly, the Appellant adjusted its VAT returns to claim the portion of input tax that was previously not deducted in full by the branches. SARS disagreed with this approach and insisted that the VAT in question should be apportioned in accordance with the standard turnover-based method of apportionment. Accordingly, SARS issued a VAT assessment, and, in addition to disallowing the deduction claimed, SARS levied penalties and interest in respect of the additional amount assessed.

## Judgment

At issue was whether the Appellant was correct to apply direct attribution (as opposed to apportioning its input tax). In making its determination, the Tax Court considered two further issues:

- Firstly, whether the exchange of currency by the branches, being a 'financial services' activity under section 2(1) of the VAT Act, qualified in terms of section 12(a) of the VAT Act to be exempt from the tax imposed under section 7(1)(a); and
- Secondly, whether the payment of a commission/fee is 'consideration' as contemplated in the proviso to section 2(1).

The Court reiterated the principle that the VAT consequences must be determined by having regard to the contractual relationship. In this instance, the contract between ABC and its customer was for the sale of currency by ABC to the customer for a commission/fee.

In the Court's view, in this case, the contract provided for the following transactions:

- the agreement to exchange specified currencies,
- at a particular rate of exchange nominated by the Appellant, and
- the payment by the customers of a commission.

As per the Court, the margin (whether notional or not) did not form part of the agreement between the parties, and it would be absurd to determine the VAT consequences based on the margin

instead of the rights and obligations arising from a contract in deciding whether a supply is taxable or exempt.

Accordingly, the Court held that the only payment the customer made to the Appellant for the exchange of currency was the commission/fee paid by the customer, and the margin earned on the currency did not detract from this. The commission/fee charged by the Appellant was 'consideration' as envisaged in the proviso to section 2(1). Following from this, the Court held that the consideration (in this case being the payment of a commission/fee) removed the activity of the 'exchange of currency' from being a deemed financial service, and therefore that the Appellant was required to charge output tax (and deduct any input tax) on expenses incurred for the exchange and sale of foreign currencies to customers by its branches.

The result was that the branches were deemed to only make taxable supplies and, as such, the Appellant was correct to apply direct attribution (as opposed to apportioning the VAT incurred by its branches).

Costs in the matter were awarded to the Appellant.

## The takeaway

Although this judgment provides guidance on the principle of direct attribution and the interpretation of financial services, it must be noted that it is only a judgment of the Tax Court. As such, it is of persuasive value only, and is not binding on any other court (including the Tax Court itself). In addition SARS has applied for leave to appeal the judgment.

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