

Tax Alert

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VAT: Deeming a single supply to be a multiple supply

In brief

In a recent judicial decision, it was held that the single supply of advertising and marketing services provided by a vendor to foreign brand owners consisted of both goods and services that were distinct and clearly identifiable from each other. It was further held that the single supply is deemed to be a separate supply of:

- goods, which attracts VAT at 15%; and
- services, subject to VAT at 0%.

The court also held that the foreign authorities referenced by the taxpayer did not find application in the circumstances.

In detail

The matter involved Diageo South Africa (Pty) Ltd ('Diageo'), an importer, manufacturer and distributor of alcoholic beverages. Diageo had entered into an agreement with foreign brand owners for the advertising and promotion of their alcoholic products in South Africa.

The foreign brand owners granted Diageo exclusive rights, in respect of the brands distributed by Diageo, to use the brand owners' trademarks, intellectual property, equipment, packages and labels in South Africa.

As with all products, the brand owners required their products to be advertised and promoted in South Africa.

The brand owners did not perform or undertake these activities themselves but relied on Diageo to render these services. Diageo charged a fee, which was calculated with reference to the costs and expenditure incurred on advertising and promoting the brand owners' products.

The advertising and marketing activities included advertising media cost, digital, website design and build, social networks and sponsorship of, amongst others, sports events. In addition, Diageo made use of promotional merchandise and packaging; alcoholic products for sampling; and branded giveaway items such as glasses, optics, towels, beer mats, lanyards, keyrings, T-shirts,

aprons, caps and the like. These were given away free of charge to third parties for use or consumption within South Africa for purposes of promoting the product.

Diageo levied VAT at the zero rate on its advertising and promotion supplies to foreign brand owners in accordance with section 11(2)(l) of the VAT Act.

The South African Revenue Service ('SARS'), however, applied section 8(15) of the VAT Act and deemed Diageo to have made separate supplies of zero-rated services and standard-rated goods (i.e. promotional goods and samples that were not exported but consumed in the South Africa).

SARS assessed Diageo for the output tax to the extent of the goods supplied. Diageo challenged the additional assessment in the Cape Town Tax Court, which disagreed with Diageo and held that SARS was correct in applying section 8(15).

Diageo then appealed the matter to the Supreme Court of Appeal ('SCA') [*Diageo South Africa (Pty) Ltd v Commissioner for the South African Revenue Service (330/2019) [2020] ZASCA 34 (03 April 2020)*].

The SCA noted the following before awarding judgment in favour of SARS:

- Section 8(15) is a deeming provision. *'The intention of a deeming provision, in laying down an hypothesis, is that the hypothesis shall be carried as far as necessary to achieve the legislative purpose, but no further.'*

In applying the above *dictum*, the SCA was satisfied that the purpose of section 8(15) is to provide for a situation where the provisions of sections 7(1)(a) and 11(2)(l) are applicable to a single supply of goods, or services, or goods and services. It further accepted SARS' view that section 8(15) creates a situation that does not exist to in fact exist (i.e. creation of an additional artificial supply).

In reaching its decision, the SCA relied on the findings in *Commissioner for SARS v British Airways plc 2005 (4) (SCA) 231*, namely *'The section applies to a single supply of goods or services comprising parts that would each, if they had been supplied separately, have attracted a different rate of tax. In such cases, each part of the single service is deemed to be a separate supply of goods or services – although, in truth, they are not – with the result that the separate parts each attract the tax that is levied by s 7 but at different rates (0% for that part of the service that, had it been separately supplied, would have*

fallen within s 11, and 14% for the remainder). A "single supply of services" is only capable of notional separation into its component parts, as contemplated by the section, if the same vendor supplies more than one service, each of which, had it been supplied separately, would have attracted a different tax rate. If that were not so, there would be no parts of the "single supply of services" by the vendor capable of notional separation from one another.'

- There are three jurisdictional requirements that must be met before the deeming provision can be invoked, namely:
 - there must be a 'single supply' of goods or services, or a combination of goods and services;
 - a single consideration must be payable for the supply; and
 - a determination of whether, if the supply of the goods or services or of the goods and services were charged for separately, VAT would be charged partly at the standard and partly at the zero rate.

The SCA was satisfied that the three jurisdictional requirements of section 8(15) were applicable to Diageo's supplies to foreign brand owners, and Diageo was liable to charge 15% VAT on the supply to the extent it comprised promotional goods.

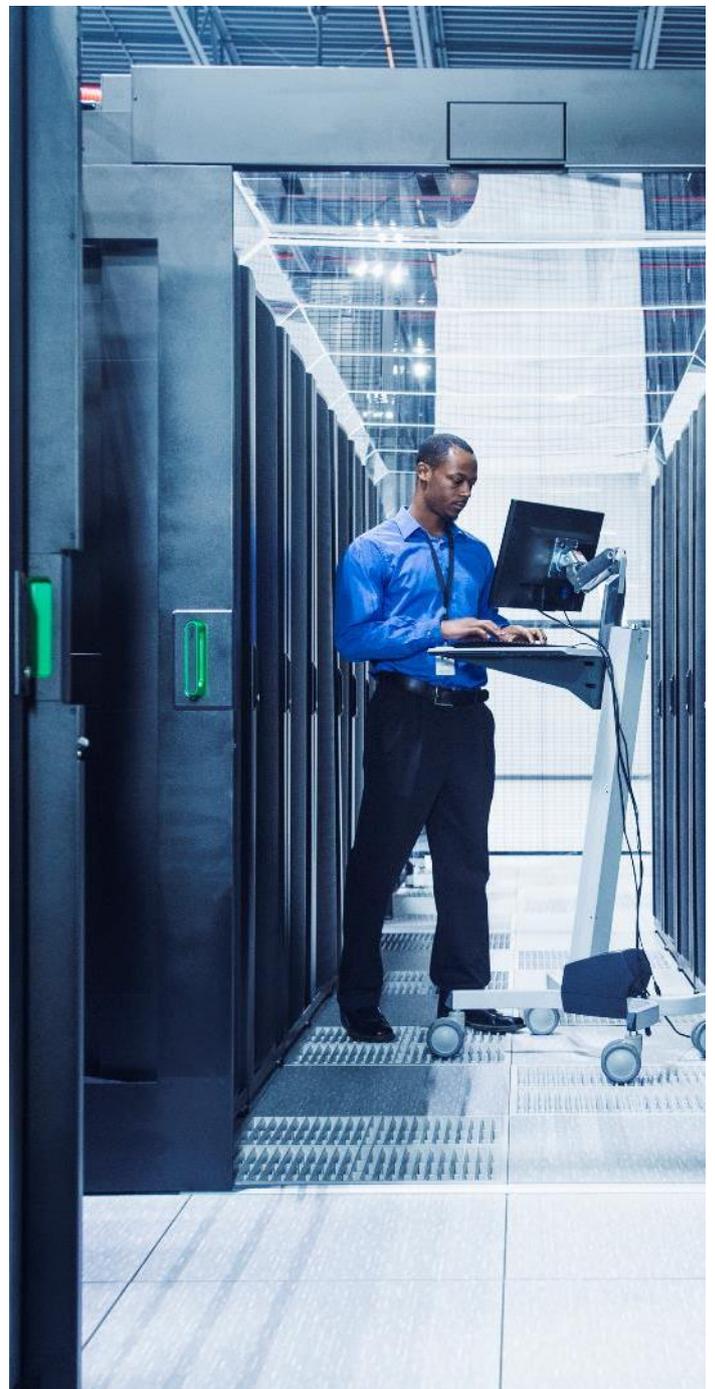
The SCA rejected Diageo's reliance on foreign authorities to deal with the interpretation of statutory provisions as they were not dealing with the *'functional equivalent of the deeming provision or an apportionment provision as one finds in s 8(15) of the Act and have very little in common with section 8(15).'*

The SCA judgment has a significant impact on these types of supplies as it creates a unrecoverable VAT cost for these foreign brand owners. In other international jurisdictions, this type of judgment might not be so significant where a refund mechanism allows non-resident businesses to recover such VAT charged. South Africa, however, does not currently have any mechanism in place to provide relief to the foreign brand owners in these circumstances and the VAT therefore becomes a cost.

The judgment undoubtedly creates tax disparity between local businesses and foreign businesses, on the basis that local businesses will be entitled to deduct the VAT on promotional items as input tax, which do not constitute non-deductible entertainment.

Takeaway

- In light of the decision, taxpayers should critically analyse all their supplies to determine if they are making a single supply of goods/services that can be regarded as having divisible components that are clearly distinct and identifiable.
- This analysis should further be considered in the context of section 10(22), which provides a similar deeming provision when one is not only making taxable supplies, but perhaps exempt or non-supplies as well.
- One should be careful in placing reliance on foreign jurisprudence in making tax decisions, as the courts are hesitant to necessarily accept such principles in circumstances where there isn't a clear and similar provision in the South African legislation.



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