



THE CONSTITUTION AND IT'S VAT IMPACT ON GRANTS

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CIGFARO WESTERN CAPE BRANCH SEMINAR

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Fallacies relating to “grants” i.t.o. VAT Act

1

Payments, other than for service charges, by provincial & national department to municipalities, are grants and no output tax is payable



- Even if amount is reflected in a government gazette as grant, the amount receivable by the municipality must still be assessed for VAT purposes
- Question that should be asked – is the municipality receiving the funds in respect of, in response to, or for the inducement of the supply of goods and services? – i.e. is there an actual supply of services in return for payment

Fallacies relating to “grants” i.t.o VAT Act

2

Payments in terms of the National Housing Programme (NHP) {Human Settlement Development Grant – beneficiaries} is a grant for VAT purposes



- Payments in terms of the NHP are specifically excluded from the “grant” definition of the VAT Act
- NHP payments represents payments made for actual supply of services deemed to be made to the state organ making the payment – ordinarily zero-rated for VAT
- GRAP 11 – Construction contracts relevant to NHP payments....

Fallacies relating to “grants” i.t.o VAT Act

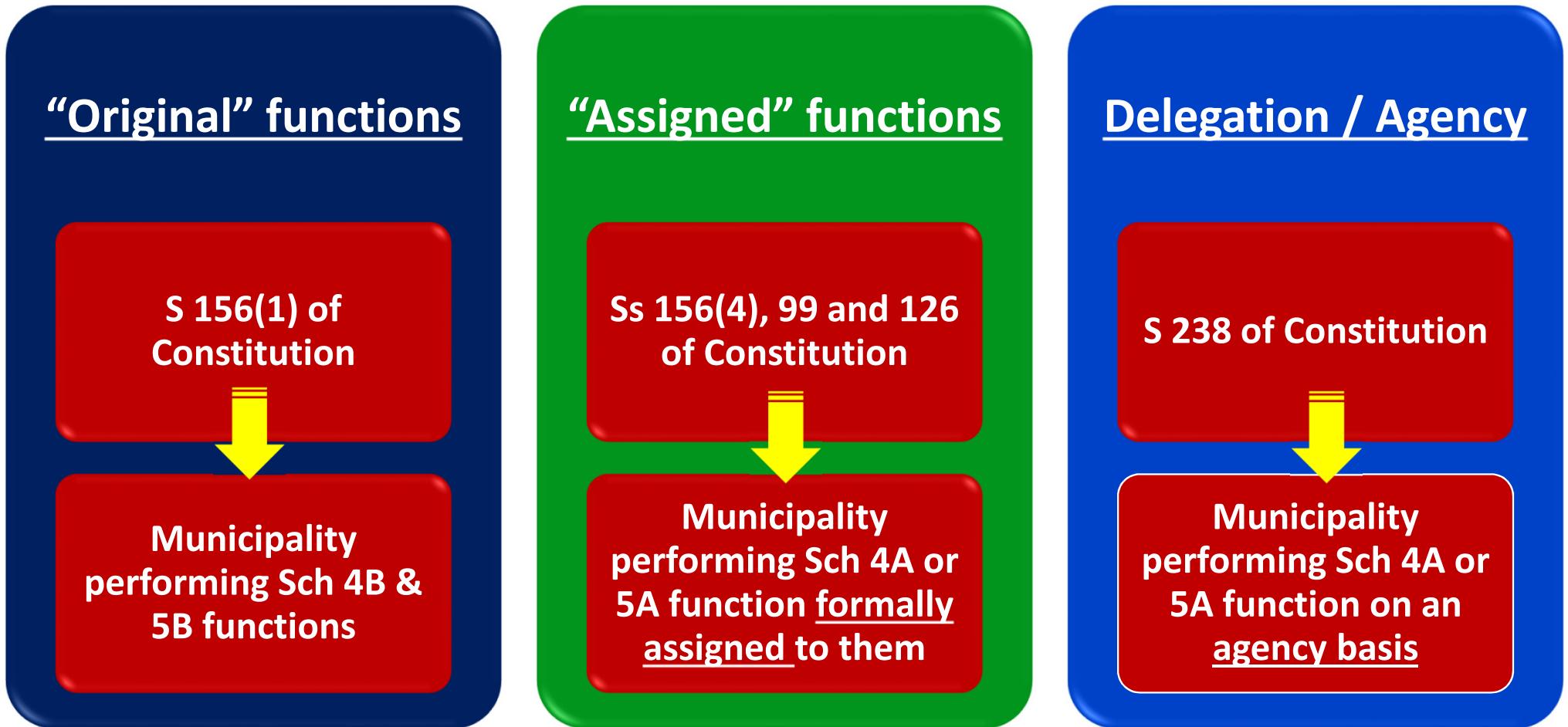
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“Grants-in-aid” payments i.t.o s67 of the MFMA always qualify as “grants” for VAT purposes & the entities that receive the funds does not have to declare output tax

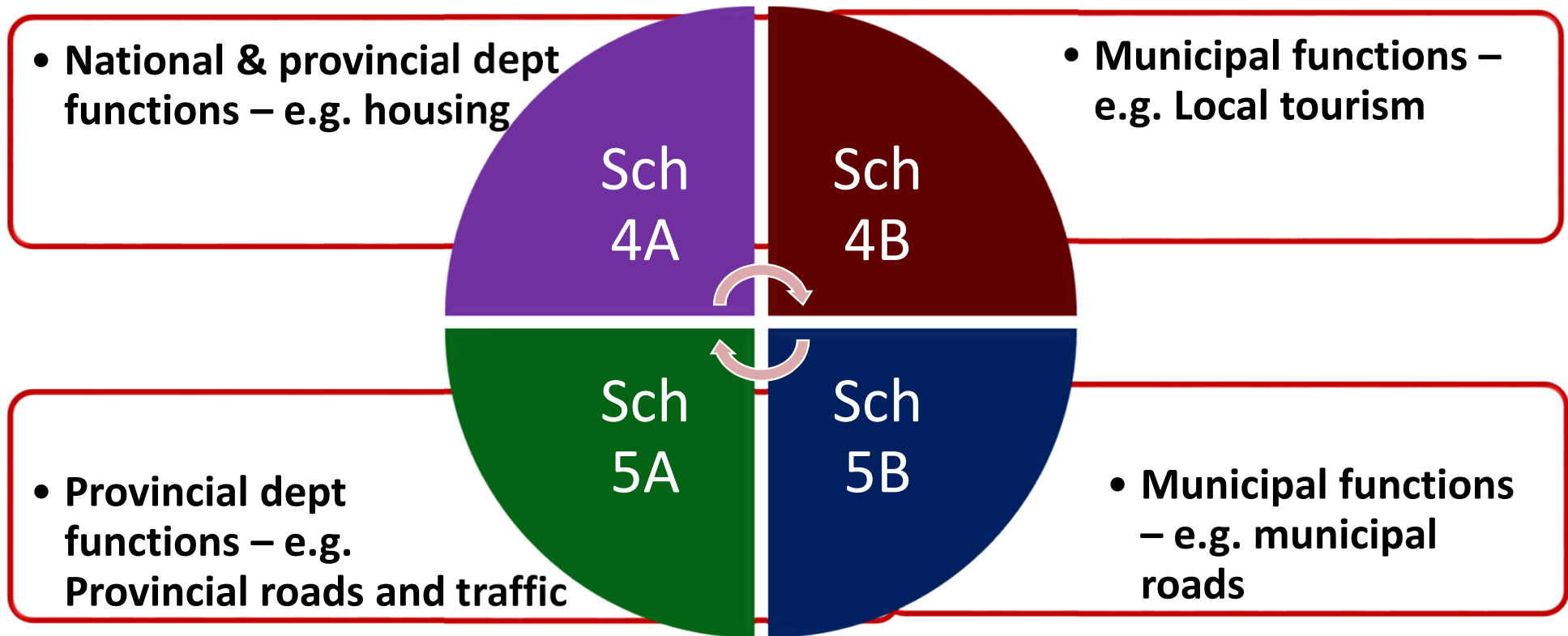


- Not all the time!
- E.g. where municipality makes “grants-in-aid” payments to local tourism entities and SPCAs, it may attract output tax for the entities, as the tourism entities and SPCAs are performing services to the municipality for the payments - (Local tourism and animal care facilities are functions of the municipality)
- Municipality may claim input tax

Relevant “function” sections as contemplated in the Constitution



Function schedules to the Constitution



Requirements for the assignment of functions to municipalities

1. There must be an agreement

The assignment of the function must be i.t.o agreement of Cabinet Minister or Provincial MEC with the municipal council

2. Must be i.t.o of an Act of Parliament or Provincial Act

Assigned function must be performed in terms of an Act of Parliament or Provincial Act

If function not performed i.t.o an Act of Parliament or Provincial Act, than “Agency services” are rendered

3. Proclamation

Assignment takes effect when it is proclaimed by the President or Premier of province

Brief literature review of “agency services concept”

White paper on local government

“Agency payments are
fees rather than grants
...”

MFMA Circular No. 59

“Agency payments from national & provincial government to local government are unlikely to be regarded as grants for VAT purposes”

“The municipality is performing service for relevant department and so agency payments to municipality are subject to VAT provisions.”

VAT 419 guide

“If provincial activity has not been assigned to a municipality, any payment by province to municipality for goods or services supplied on their behalf is not a zero-rated “grant”

The important VAT court cases

**National Educare Forum v 2002
Commissioner, South African
Revenue Service (3)SA 111 (TkH)**

**Marshall and Others v Commissioner,
South African Revenue Service [2018]
ZACC 11**

Facts:

Applicant entered into agreement to prepare and deliver food to public schools by using other sub-contractors, for which the applicant received a service fee

Trust rendered a 'comprehensive aero-medical service' on behalf of the provincial health departments to patients

Outcome:

Applicant not an agent or conduit for provincial department, but was rendering a service to the provincial department – service fee subject to output tax

Trust rendered actual services to provincial department and not deemed services – VAT is payable on payments received by Trust – Payments NOT zero-rated

Takeaway:

An entity must be authorized to act for and on behalf of organ of state with other 3rd parties to be regarded as an agent

Where there is an actual supply of services to organs of state, VAT must be paid – s8 of VAT Act is only effective when there is no actual supply but a deemed supply i.t.o of VAT Act– s8(5)(A)

SARS's policy: functional scenario under the Constitution



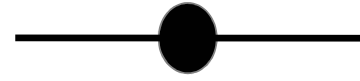
1. "Original" functions
=
Municipality performing sch 4B & 5B functions



2. Assignment of function
=
Municipality performing formally assigned sch 4A & 5A functions



3. Unfunded Mandate
=
Municipality performing sch 4A & 5A functions NOT formally assigned to them



4. Agency
=
Municipality performing sch 4A & 5A functions as legal agent of department OR provide service / goods to department in support of sch 4A & 5A functions



Output tax principles: non-core functions performed by municipality



Output tax outcome = Payment received from National or Provincial department	<u>Assignment of function</u>	<u>Unfunded Mandate</u>	<u>Agency</u>
	Funds received from department deemed a grant for VAT purposes = NO output tax payable	NO funds is received from department, hence an unfunded mandate = NO output tax effect	Subject to 15% output tax BUT ONLY amount for own account

Subject to the function not amounting to an exempt supply under the VAT Act



Input tax principles: non-core functions performed by municipality



Input tax deduction principles	<u>Assignment of function</u> ↓	<u>Unfunded Mandate</u> ↓	<u>Agency</u> ↓
	Can claim input tax on qualifying VAT expenditure	Can claim input tax on qualifying VAT expenditure	Can claim input tax on qualifying VAT expenditure

Subject to the function not amounting to an exempt supply under the VAT Act



The takeaway as it relates to non-core functions performed by municipalities

1

If function not formally assigned to a municipality
– any amount received from department for rendering non-core function IS NOT A GRANT – 15% output tax payable if not exempt supply

2

It is possible to have an unfunded mandate and performing an agency service for the same non-core function

3

Cannot have an unfunded mandate & receive “grant” from department – “grant” is payment for services rendered
15% output tax payable if not exempt supply

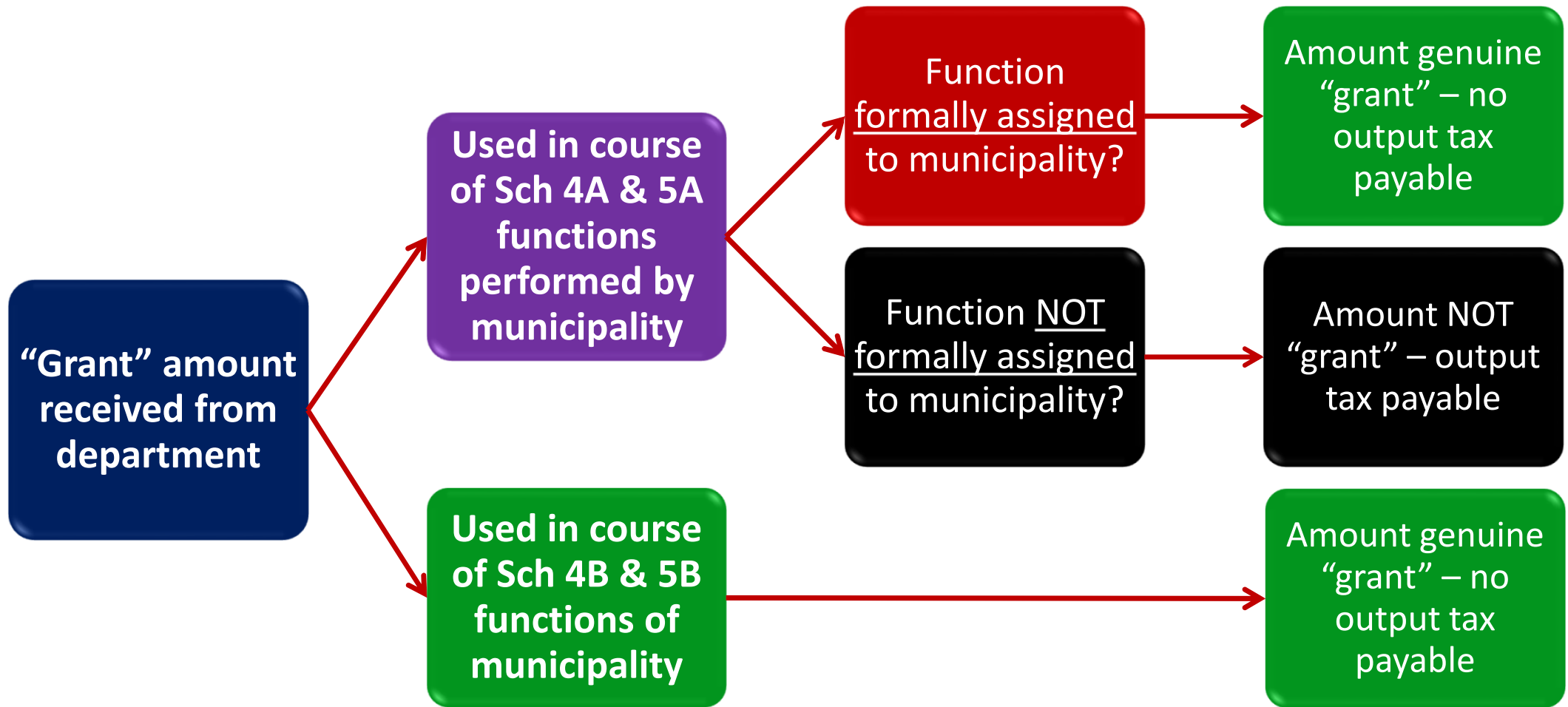
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Be careful for substance over form “limitation of GRAP” on concluding on payments received from provincial departments for VAT purposes

5

Only if non-core function is formally assigned is amount paid by department to municipality to perform function a “deemed grant”

Practical considerations to determine output tax outcome of “grants” received by municipalities





Thank You

