

Value-added tax & transfer duty: Clarity or confusion?

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Where fixed property is purchased by a VAT vendor from a non-vendor, transfer duty is payable thereon by the purchaser. The fixed property purchased from a non-vendor is regarded as second-hand goods in terms of the VAT, Act 89 of 1991 (VAT Act). To the extent that the property is purchased for the purpose of making taxable supplies, the purchasing VAT vendor is entitled to a notional input tax deduction equal to the tax fraction (15/115) of the lesser of the consideration in money paid by the vendor for the supply of the fixed property, or the open market value thereof.

The relevant provisions of the VAT Act that should be considered to determine the value on which the notional input tax deduction should be calculated is the definition of *input tax* and the definition of *consideration* as contained in section 1 of the VAT Act.

Input tax is defined as including, *an amount equal to the tax fraction of the lesser of any consideration in money given by the vendor or the open market value of the supply (not being a taxable supply) to him by way of a sale by a resident of the Republic of any second-hand goods situated in the Republic.*

Consideration is defined to mean, *in relation to the supply of goods or services to any person, any payment made or to be made (including tax), whether in money or otherwise, or any act or forbearance, whether voluntary or not, in respect of, in response to, or for the inducement of, the supply of any*

goods or services, whether by that person or any other person

Where fixed property is acquired from a seller who is not registered for VAT, the purchaser will generally incur four separate types of expenses, namely the purchase price of the property payable to the seller; the transfer duty payable to the South African Revenue Service (SARS); the transfer costs payable to the deeds office; and the conveyancing costs payable to the conveyancer.

Given the broad definition of the term *consideration*, questions have arisen regarding exactly which costs associated with the purchase of fixed property may be taken into account for purposes of determining the input tax deduction. For example, where fixed property is purchased from a non-vendor, should the transfer duty and conveyancing costs be included in the *consideration* paid?

SARS has previously ruled that the transfer duty incurred by a purchasing vendor may not be included in the amount of *consideration* when calculating the notional input tax credit. This is on the basis that the transfer duty paid is not an amount in respect of any consideration in money paid for the supply of the property. The transfer duty is not an amount paid by the purchaser to the seller for the supply of the fixed property, but rather constitutes a separate tax amount paid in terms of the Transfer Duty Act 40 of 1949, on the value of fixed property acquired by the purchaser. Although the definition of consideration includes tax, this tax refers only to VAT for purposes of the VAT Act, and not to any other taxes such as transfer duty paid in relation to the acquisition of goods or services.

It is, accordingly, only amounts paid by the purchaser to the seller for the supply of the fixed property which SARS considers to be *consideration* for purposes of calculating the notional input tax deduction.

The established views of SARS, which have been widely accepted and applied, have recently been challenged by a taxpayer in the Cape Town Tax Court (Case No. VAT 1857). The Tax Court was tasked with determining whether the amount of consideration for purposes of calculating the notional input tax deduction should include the amount of transfer duty paid in respect of the fixed property purchased.

The facts

The taxpayer, a property developer, purchased five fixed properties from sellers who were not registered VAT vendors and was accordingly required to pay transfer duty in respect of the acquisition of such properties. The taxpayer claimed notional input tax deductions in respect of the properties acquired. The notional input tax deductions were calculated on the purchase price paid by the taxpayer to the seller and the transfer duty paid by the taxpayer.

SARS disallowed the inclusion of the transfer duty in the amount of consideration to which the tax fraction was applied, thereby reducing the taxpayers notional input tax deduction. The taxpayer appealed to the Tax Court against the assessments issued by SARS in this regard.

Legal considerations and the judgment

The Tax Court, in an as yet unreported judgment, acknowledged that a fundamental principle of the VAT system is that VAT is a tax on added value imposed at each step along the distribution chain, and is a cost ultimately borne by the final consumer. In deciding the matter, the Tax Court considered the definition of *input tax* and the definition of *consideration* as contained in section 1 of the VAT Act.

The Tax Court applied the principles applicable to the interpretation of statutory provisions, being that consideration must be given to the language used, the context in which it appears and the purpose of the provision. The Tax

Court identified the question before the court as being whether the words *any consideration in money given by the vendor* includes the payment of transfer duty payable in respect of the purchase of the fixed properties.

In applying the principles of interpretation, the Tax Court applied the plain meaning of the words and held that the broad definition of *consideration* in section 1 of the VAT Act, which includes any payment made in respect of the properties, is unambiguous and held that the clear language used includes transfer duty paid.

SARS led evidence and made submissions that it is SARS practice to regard the purchase price paid in respect of the sale of immovable property to be the only *consideration* that is used for the purpose of calculating the notional tax credit, and that the transfer duty paid must not be included for such purposes. The Tax Court disregarded SARS submissions on the basis that SARS practice should not play a role in the objective and independent interpretation of legislation by the courts.

The Tax Court concluded that transfer duty must be included in the *consideration* paid for fixed property. It stated that its conclusion is based on the clear language of the legislation, and that the conclusion reached is sensible and not unbusiness-like. Furthermore, the Tax Court held that its conclusion is supported by the purpose of the notional input tax deduction allowed in respect of second-hand goods; this purpose being that it was introduced to eliminate double VAT charges on the same value-added by allowing notional input relief in the absence of actual inputs.

Comments

In view of the significance of the judgment, we understand that SARS has filed for leave to appeal, which we understand has been granted. The court of appeal (the High Court or the

Supreme Court of Appeal) will therefore be required to clarify whether the consideration, is only the amount paid to the seller, or whether it includes the transfer duty amount paid, when calculating the notional input tax deduction on the purchase of fixed property from a non-vendor. Vendors who seek to claim notional input tax deductions on the acquisition of fixed property should apply this judgment with caution, lest they find themselves liable for penalties and interest resulting from input tax overclaimed, should a court of appeal find in favour of SARS and overturn the Tax Court judgment.