

VAT on Grants versus Consideration for Supplies

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Non-profit organisations (NPOs) or Public Benefit Organisations (PBOs) often receive funding, payments, or consideration from public authorities or municipalities (Government). This frequently gives rise to uncertainty regarding the treatment of payments received from Government which could result in the VAT vendor treating the receipt incorrectly. If Government engages with a vendor to acquire goods or services, an actual supply is made. However, uncertainty arises if payment received from Government does not relate to the procurement of goods and services. VAT vendors or welfare organisations should carefully consider the VAT implications arising from funding received from Government. A common misconception is that funds received from Government are not subject to VAT at the standard rate but at the zero-rate, especially when the recipient is a welfare organisation. It is therefore critical that welfare organisations which receive Government funds determine the reason for the payment received. In extent, whether it relates to an actual supply of goods or services or not (namely for a grant). The VAT Act defines a grant to include an appropriation, grant in aid, subsidy or contribution transferred, granted or paid to a welfare organisation. A grant does not include payment for goods or services, if such goods or services are acquired in accordance with a procurement process.

The term consideration relates to payment made or to be made, whether in money or otherwise in respect of the supply of goods or services. Essentially it requires a reciprocal agreement in terms of which goods or services will be supplied. In a Supreme Court of Appeal (SCA) case, the Commissioner for the South African Revenue Service (SARS) v Marshall NO (October 2016) (Marshall NO) the South African Red Cross Air Mercy Service Taxpayer (the Taxpayer) received payments from Government for aero-medical services (the services) provided to provincial health departments. The Taxpayer is a registered VAT vendor and a welfare organisation for VAT purposes. The dispute, between the Taxpayer and SARS related to the VAT treatment of the payments received from Government relating to the services. The Taxpayer initially applied to SARS for a binding private ruling requesting confirmation of the appropriate VAT treatment of the payments received in respect of the services. The Taxpayer specifically wanted confirmation whether the payments received for Government related activities, constituted consideration for an actual supply of services and whether the zero-rate applies. SARS ruled, that the payments received constituted consideration for an actual supply of services which is subject to the standard rate. The taxpayer applied to the High Court for a declaratory order to confirm that the supplies should be subject to VAT at the zero-rate. The High Court concurred that the zero-rate should apply. SARS then appealed to the SCA. The SCA held in favour of SARS, providing clarity on the VAT treatment of services supplied to Government. The SCA concluded that the supply of the services is a commercial supply subject to the standard rate. The SCA held that a PBO engaged in commercial activities (supply of goods or services) should be treated as any other commercial entity. The SCA also held that the nature of the payment should not be the common denominator when the correct VAT treatment is identified, and that the use of the word payment instead of consideration, is not coincidental. Based on Marshall NO, VAT vendors should differentiate between commercial transactions and grant

related activities.

What will happen if the vendor incorrectly accounts for VAT at the zero-rate? SARS must issue an assessment and apply the standard rate. SARS will levy understatement penalties (up to 200%), interest on a late payment of taxes, and a late payment penalty, which can severely impact cash flows, especially for welfare organisations. Welfare organisations or PBOs can disclose VAT liability understatements through the SARS Voluntary Disclosure Programme. Uncertainty is best dealt with through a tax professional.