Analysis – CSARS v De Beers Consolidated Mines Ltd (503/11) [2012] ZASCA 103

IS IT SUFFICIENT FOR EXPENDITURE TO MERELY BE CONNECTED TO BUSINESS-RELATED ACTIVITIES IN ORDER TO DEDUCT INPUT TAX?

The case of CSARS v De Beers (503/2011) [2012] ZASCA 103 dealt with a complex transaction that is unlikely to occur regularly, but some important general considerations were nevertheless touched on in this judgment.

In brief, the background to this case was that De Beers Consolidated Mines Ltd (hereafter DBCM) was approached by a consortium with an offer for a restructuring in terms of which a new company that would be owned by the consortium would be established. This would enable the consortium to effectively become DBCM's holding company. In order to advise the board and existing shareholders on whether the consortium's offer was fair and reasonable, DBCM engaged a London based consulting firm as well as South African advisors.

VAT implications of the services acquired from the foreign service provider

SARS argued that the fee of approximately R160 million paid to the foreign service provider constituted an imported service and that DBCM was therefore liable to pay output tax on this fee paid in terms of section 7(1)(c). The following definition of an imported service is relevant in this regard:

"'imported services' means a supply of services that is made by a supplier who is resident or carries on business

outside the Republic to a recipient who is a resident of the Republic to the extent that such services are utilized or consumed in the Republic otherwise than for the purpose of making taxable supplies" (own emphasis added in italics)

The taxpayer argued that the services were not imported services as it, firstly, related to DBCM's enterprise because of the fact that the duty to obtain this advice was imposed by law4 and that, secondly, the services were not fully consumed in South Africa as some of the meetings with the foreign service providers were held in London.

The judges had differing reasons for their views but all concluded that the services constituted imported services for the following reasons. In the first place it was held that the services, despite stemming from a requirement imposed on DBCM by law, were too far removed from the activities that constituted DBCM's enterprise making the taxable supplies (mining and selling diamonds) to be said to have been acquired for the purposes of making taxable supplies in the course of this enterprise. The court was of the view that these services were not normal overhead costs necessary to make taxable supplies and represented services acquired for the benefit of the company's shareholders, as opposed to being consumed or utilised in the course of the taxpayer's enterprise for VAT purposes. It was also held that incidental links or benefits to the enterprise were not sufficient to be able to conclude that the services were acquired to make taxable supplies. Based on these views expressed, it is submitted that any expenditure incurred on services by an entity for the benefit of its shareholders or investors, which is is not directly related to the core activities of the entity, may therefore not be acquired for the purpose of making

taxable supplies and therefore not qualify for an input tax deduction.

In respect of the place of consumption of the services, it was held that irrespective of where the meetings with the advisors were held, the services were consumed in South Africa where the board of DBCM used the outputs produced by the advisors to make the decisions. It therefore appears as the courts will not be persuaded about the place of consumption of services by only considering the place where the physical activities related to the service take place, but will also consider the place where the benefits received by the recipient from this service are consumed.

Consequently, it was held that the services were consumed in South Africa and that it was not acquired for the purpose of consumption or use in making taxable supplies, due to the lack of linkage to DBCM's taxable supplies. DBCM was required to pay output tax on the imported service.

VAT implications of the services acquired from local service providers

For the same reason as the services provided by the foreign service provider, it was held that the services rendered by the local service were similarly not acquired by DBCM for purposes of making taxable supplies. DBCM was denied an input tax deduction in respect of these services.

Concluding thoughts

From the judgment in this case it is clear that the courts will not merely consider whether expenditure to acquire goods or services relate to the business making taxable supplies in general but rather whether a direct or clearly identifiable relationship exists between the goods or services acquired and

the taxable supplies of the vendor.