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NATIONAL GOVERNMENT AND VAT

Government also consumes goods and services. It uses the inputs to provide goods and services on a non-commercial basis. It follows that VAT is generally not charged by governments on any goods and services supplied to the public and any VAT incurred in acquiring goods and services to make those supplies is a cost to government. Generally, the supplies by government and are not supplied by the private sector, and as a result, are not in competition with the private sector. Hence VAT is not charged on supplies by government. Examples of such supplies are the issue of motor car licenses, and the issue of drivers’ licences.

Hence government departments are not required to register for VAT. The appropriations made to national and provincial departments are outside the scope of VAT since these departments do not make supplies which are in competition with other vendors in the private sectors.

National and provincial public entities listed in Part A and C of the Schedules 3 to the PFMA, are treated on the same basis as national and provincial departments. The supplies by these entities involves activities of a regulatory nature.

Government and provincial departments as ‘Public Authority’.

The definition of “public authority” was therefore amended with effect from 1 April 2005 to clarify that the following entities fall within the ambit of the definition:

1. “any department or division of the public service as listed in Schedules 1, 2 or 3 of the Public Service Act, 1994 103 of 1994; or
2. any public entity listed in Part A or C of Schedule 3 to the Public Finance Management Act 1 of 1999; or
3. any other public entity designated by the Minister for the purposes of this Act to be a public authority.”

Entities that are included in definition of “public authority” can therefore be summarised as follows:

- Entities listed in Parts A and C of Schedule 3 to the PFMA (including any subsidiary or entity under the ownership control of that entity); and
- All the national and provincial government departments listed in Schedules 1, 2 or 3 of the PSA (including any branches, divisions, trading accounts, local offices and other components of that department).
Entities that are **excluded** from the definition of “public authority” are summarised as follows:

- Constitutional institutions listed in Schedule 1 to the PFMA;
- National or provincial government business entities listed in Parts B and D of Schedule 3 to the PFMA;
- Major public entities listed in Schedule 2 to the PFMA;
- Entities that are party to a public private partnership (PPP);
- Municipalities and municipal entities; and
- Any institution of higher education.

It is understood that `public authority’ must not register for VAT and that a municipality is not a `public authority. Hence latter must register for VAT.

**`Enterprises’ and `designated entities’**

Paragraph (b)(i) of “enterprise” refers to the supplies made by public authorities and identifies the different types of supplies which are similar to, or which compete with, taxable supplies made by any other vendor under paragraph (a) of the definition of “enterprise”.

In the case of public authorities, which adopted a business rationale, or business test, and which forms an integral part of the thinking behind the government national and provincial departments, are described as `designated entities’ and must register for VAT. South African Airways Limited (SAA ) and Telkom SA Limited are important entities that are classified as `designated entities’ and are not national department because they compete with the private sector for the delivery of their products. Please refer to Schedule 2 from the PFMA – see separate attachment.

The definition of a “designated entity” was introduced with effect from 1 April 2005.

A designated entity is a specific kind of vendor, namely:

- a “public authority” which is registered for VAT under paragraph (b)(i) of “enterprise” (only to that extent); or
- a major public entity listed in Schedule 2 to the PFMA; or
- a national government business enterprise or provincial government business enterprise listed in either Part B or D of Schedule 3 to the PFMA; or
- a “PPP” as defined in the PFMA and the Treasury Regulations; or
- “welfare organisation”; or
a “municipal entity” (as defined in section 1 of the Local Government: Municipal Systems Act 32 of 2000); or

an entity which has powers similar to those of any water board listed in Part B of Schedule 3 of the PFMA.

In other words, designated entities are entities in which government has an interest. Government may therefore assist a designated entity by funding their activities either on an ongoing basis, or from time-to-time, as required. For example, government may be the majority or sole shareholder in a major public entity, or the entity might be involved in delivering public goods and services which are in competition with other vendors.

Section 8(5) of the VAT Act applies only to designated entities, any payment such as an institutional subsidy paid by a public authority to assist a designated entity to carry on its enterprise activities is subject to VAT at the standard rate with effect from 1 April 2005.

There are, however, two exceptions when the deemed supply which arises in the hands of a designated entity will qualify to be taxed at the zero rate, namely:

1. when a gratuitous payment is made to a welfare organisation – in which case the zero rate under section 11(2)(n) will apply; and
2. when a “grant” (as defined) is paid to the designated entity under section 10(1)(f) of the Skills Development Act 97 of 1998 for training its employees – in which case the zero rate under section 11(2)(u) will apply.

**Ring fencing of trading activities of designated entities**

Public authorities do not register for VAT unless they are classified as ‘designated entities’.

In order for a public authority to qualify as an “enterprise”, the activity which is sought to be treated as taxable must be “ring-fenced” and moved out of mainstream non-enterprise activities of that department or Schedule 3A or 3C PFMA entity and conducted under a separate subsidiary legal entity (unless all of the activities conducted by that public authority are regarded as taxable). The objective is to re-classify these activities away from the activities of Public Authorities.

Alternatively, the taxable activity must be “ring-fenced” and conducted under a separate trading account, branch or division of that public authority. The separate entity or taxable trading account, branch or division must then be notified to register or apply for registration.
Section 50 of the VAT Act allows for the separate registration of a branch or division provided that the branch/division maintains an independent system of accounting and can be separately identified by reference to the nature of the activities carried on.

Any transfer of funds or assets from the main public authority (non-vendor) to its taxable trading account or deemed Schedule 3B or 3D “designated entity” (vendor) will have the following VAT implications:

1. Transfer of funds – Output tax must be declared by the recipient as the amount constitutes consideration for a deemed taxable supply [section 8(5)]. When the taxable trading account or deemed designated entity incurs VAT inclusive expenses, it can deduct input tax thereon to the extent that it makes taxable supplies if it meets all the other requirements for deducting input tax.

2. Transfer of existing assets and other goods and services held before 1 April 2005 – No input tax adjustment can the separate taxable trading account or deemed designated entity when it receives those goods or services for taxable application in the enterprise.

3. Purchase and transfer of goods or services acquired on or after 1 April 2005 – If the main public authority acquires goods or services on or after 1 April 2005 on its budget (as principal) and these are subsequently transferred to a separate taxable trading entity or deemed designated entity, neither the main public authority (non-vendor), nor the recipient can deduct input tax thereon. This requires further clarification.

ILLUSTRATIVE EXAMPLE 1
Change in use from non-taxable to taxable use or application

Background information:
Provincial Department A purchased a single-cab bakkie on 1 April 2018 for its exclusive use in the department – it is a public authority. The bakkie cost R230 000 (including VAT). On 1 September 2018, a new entity (assuming a Municipality) will use the bakkie exclusively in the township development division for purposes of transporting building equipment to the various building sites (wholly for taxable supplies). The new entity – a Municipality - will monitor and oversee the building of these sites. The bakkie was transferred to the Municipality on 1 September 2018.
At the time of the change in use the bakkie had an open market value of R150 000.

**Question:**
What is the VAT consequence of this change of use of the bakkie?

**Answer:**
As the bakkie was originally acquired for non-enterprising purposes by the Provincial Department, no input tax would have been allowed on the original acquisition.

However, if both parties belonged to the private sector and were registered vendors, the transferor would have had to declare an output tax of R22 500 (R150 000 × 15 / 115) and the transferee could have claimed the input tax if the transferee uses the asset (bakkie) for enterprising purposes as defined in the VAT Act. The transferee could have claimed the deduction in the tax period when 1 September 2018 falls.

Given that we are dealing with the government sector, the transferring Provincial Department does not levy output tax simply because it is not a vendor. Simultaneously, the Municipality cannot claim the input tax because it is denied under proviso (v) to section 18(4) although Municipality is a vendor for VAT purposes. But should the Municipality sell the bakkie at a future date, it will have to levy output tax on the MV at the date of sale.

**What is a Municipality?**

`Municipality` is defined section 1 of the Income Tax Act 58 of 1968, as amended'. It is an organ of State within the local sphere of government, exercises legislative and executive authority within an area determined in terms of the Local Government: Municipal Demarcation Act 27 of 1998, and which has the power to levy a municipal rate in terms of section 2 of the Local Government: Municipal Property Rates Act 6 of 2004.

However, section 155 of the Constitution of the Republic of South Africa, which deals with the establishment of municipalities. It refers to the following categories of municipalities:

**Category A:** A municipality that has exclusive municipal executive and legislative authority in its area.

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1 “municipality” means a municipality which is within a category listed in section 155(1) of the Constitution of the Republic of South Africa, 1996, and which is an organ of state within the local sphere of government exercising legislative and executive authority within an area determined in terms of the Local Government: Municipal Demarcation Act, 1998 (Act No. 27 of 1998)
Category B: A municipality that shares municipal executive and legislative authority in its area with a Category C municipality within whose area it falls.

Category C: A municipality that has municipal executive and legislative authority in an area that includes more than one municipality. Often referred to as district municipalities.

Payment basis
In terms of the VAT Act, only certain categories of persons can account for VAT on the payments basis, for example:

- natural persons or unincorporated body of person (which are all-natural persons) whose total value of vendor’s taxable supplies in the period of 12 months at the end of any tax period has not exceeded R2.5m or is unlikely to exceed in a future tax period.
- partnerships consisting of only natural persons;
- any public authority (only those classified as `designated entities”);
- Municipalities;
- municipal entities which make supplies of water, electricity, gas and refuse removal;
- suppliers of ’electronic service’ by foreign suppliers, such as Amazon; and
- SABC.

In practice, most municipalities account for VAT on the payments basis. One of the reasons for this is that municipalities have a vast customer base to which they supply many types of goods or services. As the billing for the supply of water, electricity and refuse removal cannot be done in advance, municipalities often carry many debtors which have unpaid and arrear accounts in respect of these supplies.

Any vendor, other than a municipality or public entity, which generally accounts for VAT on the payments basis, must account for VAT on the invoice basis in relation to transactions where the consideration for the supply exceeds R100 000.

ILLUSTRATIVE EXAMPLE 2

Facts:
ABC Municipality accounts for VAT on a monthly basis (Category C tax period) using the payments basis of accounting.
ABC Municipality supplies electricity to Mr V for an amount of R575 (including VAT) on 1 April 2018 and invoices Mr V for this amount on 28 May 2018.

Mr V pays the amount to ABC Municipality in two equal instalments of R287 on 7 June 2018 and R288 on 7 July 2018 respectively.

Answer:
ABC Municipality must account for output tax for the payment received on 7 June 2018 in the tax period ending June 2018. The output tax to be declared in this tax period is R37.44 (R287 × 15 / 115).

In addition, ABC Municipality must account for output tax for the payment received on 7 July 2018 in the tax period ending July 2018. The output tax to be declared in this tax period is R37.56 (R288 × 15 / 115).

Please Note:
Only the output tax implications are dealt with here, but the same principle will apply in respect of any input tax that may be deducted. When goods or services are acquired in one tax period and only paid for in another tax period, it is only in the tax period in which payment occurs that the deduction of input tax will be allowed (limited to the extent of the actual payment made).

Time of supply rule
The payments basis (or cash basis) uses the same general time of supply rule mentioned above, but the vendor only accounts for VAT on actual payments made and actual payments received in respect of taxable supplies during the period.

Registration requirements
Municipalities are not required to meet the minimum thresholds for registration – that is, R1 million for compulsory registration, and R50 000 for voluntary registration, and are able to register as vendors under section 23(3)(a) which reads:

Section 23: Registration of persons making supplies in the course of enterprises

(3) Notwithstanding the provisions of subsections (1) and (2), every person who satisfies the Commissioner that, on or after the commencement date-

(a) that person is a ‘municipality’ as defined in section 1
may apply to the Commissioner in the approved form for registration.

**Municipal Entity**
A “municipal entity” is an entity created by one or more municipalities to carry on certain activities which would otherwise be conducted by the municipalities concerned.

A municipal entity is a separate juristic person from the municipality which created it, it will have to register separately for VAT if it makes taxable supplies more than the compulsory VAT registration threshold.

A municipal entity does not conduct activities on behalf of a municipality, but rather for its own account.

**Municipal rate**
A “municipal rate” as defined in the VAT Act is a charge levied by a municipality on owners of property in the municipality’s demarcated area.

The charge is in lieu of facilities provided by the municipality to the public in its area and in respect of which it does not, or is unable, to charge a specific consideration. For example, street lighting, municipal roads and gardens, cleaning of streets etc.

Since a municipal rate is charged for facilities and services provided to the public, the term specifically excludes charges in respect of the supply of electricity, gas, water, drainage, removal or disposal of sewage or garbage; or goods or services that are incidental to, or necessary for making those supplies.

It also excludes the situation where a municipality charges a single charge (a “flat rate” or an all-inclusive rate) for municipal rates and the supplies of goods or services mentioned above. Charges for municipal rates are subject to VAT at the zero rate, but the zero rate does not apply when there is no separate charge for goods or services such as water and electricity.

This concept is illustrated below:
Each supply is itemised separately on municipal bill:

**Municipality A**
- Municipal property rates: 0%
- Electricity Bill: 15%
- Water Bill: 15%

**Municipality B**
- Municipal property rates
- Electricity Bill: 15%
- Water Bill

**Deemed supply**
`Deemed` supplies include events or transactions in the meaning of “supply”. These events are not a supply in the traditional sense but are viewed as supply for VAT purposes.

In a municipal environment, the receipt of a grant from a public authority for the purposes of making taxable supplies is a deemed supply.

**Grant**
A “grant” as defined in section 1(1) of the VAT Act and `means any appropriation, grant in aid, subsidy or contribution transferred, granted or paid to a vendor by a public authority,`
municipality or constitutional institution listed in Schedule 1 to the Public Finance Management Act, 1999 (Act No. 1 of 1999) – see separate attachment.

The best way to understand a ‘grant’ is to view it as a gratuitous or “unrequited” payment by the grantor. This refers to any gratuitous or unrequited payment by the grantor, where the recipient does not supply goods or services of corresponding value in return for the grant.

A ‘grant’ is generally subject to VAT at the zero rate if the grant is received for taxable purposes.

Where there is an actual supply of goods or services by a recipient, the payment does not qualify as a “grant” as defined and any supply made in return for that payment will be subject to VAT at the standard rate (provided the supply concerned is a taxable supply).

Any payment made by the Department of Human Settlements to a vendor (including a municipality) under a national housing programme is not a grant. (The potential zero-rating of such payments must be considered under sections 8(23) and 11(2)(s). Section 8 (23) is likely to be deleted on 1 April 2019.

Where the recipient is required to perform minor actions concerning the grant, such as providing the grantor with a report on how the grant funds were spent, those actions are not regarded as an actual taxable supply of “services” by the grantee to the grantor.

For example, when a municipality receives its equitable share grant, to the extent that the funds are in support of the taxable activities of the municipality, that municipality is deemed to make a supply to the Department that makes the payment.

All the municipality does in that case is to use those funds to carry out its constitutional functions within the local sphere of government. There is no actual supply of goods or services to the Department in return for that payment.

However, where a Department pays the municipality to make an actual supply of electricity or water to the Department (public authority), or to supply actual services, for example, to collect vehicle licence fees on behalf of a Provincial Department, the payment of commission in that regard does not constitute a “grant” in the hands of the municipality.
Similarly, where a municipality makes a payment to a private vendor, that receipt will not constitute a “grant” if it is in fact payment for any goods or services actually supplied by that vendor to the municipality. For example, if a municipality pays a vendor an amount every month to clean the beaches within the municipality’s demarcated boundary, the payment to that vendor is not unrequited and can therefore not qualify as a “grant”. It is clearly a payment for services rendered (being the cleaning of the beaches) and VAT on the consideration paid or payable for those services must be charged at the standard rate.

ILLUSTRATIVE EXAMPLE 3
Tax case law:
*CSARS v Marshall NO (816/2015) [2016] ZASCA 158 (3 October 2016).*

In this case, the Supreme Court of Appeal had to decide if VAT was payable at the standard rate on the actual supply of certain air rescue services provided by a welfare organisation to the provincial government as contended by the Commissioner for SARS.

Alternatively, if the effect of the contract was to give rise to a deemed supply of services under section 8(5) which meant that the services would be subject to VAT at the zero-rate under section 11(2)(n) – refers to activities carried out by welfare organisations – as contended by the Appellant. The court held that section 8(5) of the VAT Act does not apply to the actual supply of services and therefore the payment did not qualify to be zero-rated under section 11(2)(n).

A payment is therefore not a zero-rated “grant” where:

- it constitutes payment for the actual supply of goods or services by the person making the payment;
- it constitutes a conditional loan which must be repaid to the lender either in the form of money, or in the form of a supply of goods or services upon the happening of a future event;
- the payment is made in exchange for the supply of shares in a public entity, municipal entity or other juristic person; or
- the grantor pays a supplier of taxable goods or services directly on behalf of the grantee instead of paying the grant amount to the grantee.
Grant to municipalities

Services are deemed to be supplied under section 8(5A) (excludes a designated entities) to the extent that a grant is received by a municipality from a public authority, constitutional institution, or another municipality. This deemed supply is zero-rated under section 11(2)(t), provided that the grant is for assisting the municipality to make taxable supplies of goods or services in the course of its enterprise.

If a grant is received for the purposes of exempt or other non-taxable purposes, it does not result in a deemed supply under section 8(5A). Consequently, the municipality will not be entitled to deduct any input tax in respect of any goods or services acquired to carry on the non-taxable activities for which those funds were intended.

A “grant” must be attributed and declared on the VAT 201 return according to whether the payment relates to taxable, exempt or other non-taxable supplies. If the grant is for both taxable and non-taxable purposes, the receipt must be attributed accordingly. For example, if 30% of a grant is for subsidising the municipality’s public transport business (exempt supply) and 70% is for subsidising the supply of water and electricity to customers (taxable supplies), 30% of the grant will not be taxable and the other 70% will be subject to VAT at the zero rate.

It is important to correctly reflect whether a grant is zero-rated (Block 2) or exempt/out-of-scope (Block 3) on the VAT 201 return as it affects the apportionment calculation.

Below is a list of the different types of grants which may be made by national or provincial government to municipalities:

- Municipal Systems Improvement Grant
- Local Government Financial Management Grant
- Electricity Demand Side Management Grant
- Water Service Operating Subsidy Grant
- Municipal Infrastructure Grant (MIG)
- Integrated National Electrification Programme (INEP) (Municipal) Grant
- Neighbourhood Development Partnership Grant (Capital Grant)
- Public Transport Infrastructure and Systems Grant
- Rural Roads Asset Management Grant
- Equitable Share Grant

The VAT implications of receiving the listed grants as well as any other grants received from national or provincial government will depend on whether the purpose for which the grant is received is to make taxable supplies or not.
ILLUSTRATIVE EXAMPLE 4
Zero-rated and out-of-scope grants received by a municipality

Background information:
On 1 August 2015, National Treasury (a public authority) makes a payment of R5 000 000 to Municipality B in terms of the Division of Revenue Act to enable Municipality B to construct a dam. In constructing the dam, Municipality B incurs construction costs, which include VAT at the standard rate.

The Department of Transport (a public authority) also pays R200 000 to Municipality B to subsidise the provision of a bus service (passenger transport) in Municipality B’s demarcated area.

Answer:
Municipality B does not supply any actual goods or services to National Treasury or to the Department of Transport in return for the payments. However, a deemed service arises in respect of the receipt of the R5 000 000 grant payment from National Treasury under section 8(5A) – excludes a designated entity. The deemed supply concerned is zero-rated under section 11(2)(f) as the funds will be used for taxable purposes.

The VAT incurred on the construction costs in building the dam may therefore be deducted as input tax.

However, no deemed supply arises in respect of the R200 000 received from the Department of Transport as the funds will be used for exempt purposes. Municipality B will reflect this amount as an out-of-scope receipt in Block 3 of the VAT 201 return.

Grants made by municipalities
A municipality may make a payment to another vendor which will qualify as a zero-rated “grant” in the hands of the recipient. It must be borne in mind that in order to constitute a grant the amount paid should not constitute payment for the actual supply of goods or services, or be a payment to a “designated entity” such as a municipal entity.

Since a municipality is not a grant-making institution, any grant by a municipality will be an exceptional item rather than something that occurs frequently in the normal course of conducting an enterprise. It follows that an amount paid by a municipality to another person
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will more than likely constitute consideration for an actual supply, rather than an unrequited or gratuitous payment which qualifies as a “grant” as defined.

For example, if a municipality makes a payment to a public benefit organisation (vendor), that amount may qualify as a grant if the payment is unrequited in accordance with the conditions of section 67 of the MFMA. This means that the municipality does not expect (or receive) anything in the form of a supply of goods or services in return for that payment.

On the other hand, if a payment is in fact consideration for the acquisition of goods or services by the municipality or is payment for a taxable supply to a third person, the payment will not qualify as a zero-rated grant. This will apply even if the payment is said to have been made under section 67 of the MFMA. In this regard, each case must be tested against the facts to determine whether it is truly gratuitous before the zero rate of VAT can be applied by the recipient. Furthermore, words such as “grant”, “subsidy”, “grant-in-aid” or “intergovernmental grant” are sometimes used in a contract to describe payments made to the contracting party to perform activities which have been outsourced by a municipality.

It is therefore clear that for the reasons mentioned above, certain payments are not gratuitous or unrequited and will not meet the definition of “grant”.

A payment made in terms of such a contract will also not qualify as a zero-rated “grant” for VAT purposes merely because it has been called a grant by the contracting parties. Once again, each case must be evaluated on its own merits to establish whether the recipient is required to supply any goods or services in return for the payment.

A payment is therefore not a zero-rated “grant” where:

- it constitutes payment for the actual supply of goods or services by the person making the payment;
- it constitutes a conditional loan which must be repaid to the lender either in the form of money, or in the form of a supply of goods or services upon the happening of a future event;
- the payment is made in exchange for the supply of shares in a public entity, municipal entity or other juristic person; or
- the grantor pays a supplier of taxable goods or services directly on behalf of the grantee instead of paying the grant amount to the grantee.
**Agent vs Principal**
Before determining the VAT consequences of a transaction, it is necessary to establish the relationship between the parties. This is to determine if the vendor is acting as an agent on behalf of another person or as principal.

If an agent/principal relationship exists, the principal is ultimately responsible for the commercial risks associated with a transaction and that the agent is trading for the principal’s account.

The agent is appointed by and takes instruction from the principal regarding the facilitation of transactions as per the principal's requirements and generally charges a fee or earns a commission for that service.

If a vendor employs the services of an agent to acquire goods or services, or to make supplies on the vendor's behalf, the VAT on the supplies concerned must be accounted for by the principal and not the agent.

**Application of agency principles**
In terms of the Constitution, national and provincial governments are mandated to perform activities in certain functional areas, for example, vehicle licensing, road traffic regulation, provincial roads and traffic and primary health care services.

Municipalities have the right to administer certain local government activities, for example building regulations, fire-fighting services, municipal public transport, municipal roads, street lighting, traffic and parking, environmental health services, billboards and the display of advertisements in public areas.

National and provincial governments may assign, by agreement and subject to certain conditions, any of the activities mandated to them to a municipality, provided that the municipality has the capacity to administer it and the matter would be most effectively administered locally. In addition, the provincial government may appoint a municipality as agent to carry on certain activities where the provincial government may need assistance to carry out its mandated activities.

Usually a Service Level Agreement (SLA) is concluded between municipalities and provincial government when functions are assigned to municipalities, or where a municipality acts as agent of the national or provincial government to execute certain tasks. An understanding of
the relationship between the parties is therefore a requirement in understanding the VAT treatment of a supply by a municipality, as the accounting for VAT follows from the role, function and contractual capacity in terms of which the parties to a transaction carry out their activities.

In cases where a municipality has been assigned the responsibility of supplying certain goods or services (being taxable supplies) as principal:

- the activity and the supplies made will form part of the municipality’s taxable activities, and the fees or other charges in respect of the supply of those goods or services will be reflected as the municipality’s income which would be subject to VAT at either the standard rate of 15% or the zero rate; and
- the municipality is entitled to deduct input tax on the goods or services acquired for the purposes of making those taxable supplies.

Insofar as the municipality supplies exempt goods or services as principal, the amounts will also be reflected in the municipality’s income but would not be subject to VAT. As such, the municipality will not be entitled to deduct input tax on goods or services acquired for the making of these supplies.

The following example illustrates circumstances in which municipalities act as principal in an agency relationship.

**ILLUSTRATIVE EXAMPLE 5**

**Background Information:**
Province Y is not a vendor and provides primary health care (PHC) services within Municipality X’s demarcated area. Province Y’s fees are based on a standard charge of R100 per patient. Municipality X is not involved in the provision of the PHC services itself but rents a commercial building to Province Y for R20 000 per month (including VAT) from where the PHC services are supplied.

**Answer:**
Province Y is not a vendor, therefore the fee of R100 charged to patients by Province Y will not attract VAT. Furthermore, Province Y may not deduct any VAT (input tax) on expenses
incurred to provide the PHC services, for which it is the principal. Province Y will be charged VAT at the standard rate on the supply of the building by Municipality X under the rental agreement, as Municipality X is the principal in respect of the supply of the building to Province Y.

The VAT charged may not be deducted as input tax by Province Y since it is not a vendor. Province Y must therefore budget on the basis that any VAT incurred in connection with the provision of PHC services is an accounting and actual “cost”.

Municipality X, however, must declare output tax at the standard rate \((R2\,000 \times 15 / 115 = R2\,608.70)\) on the rental received for the supply of the building and it may deduct input tax on the VAT-inclusive expenses incurred on maintaining the building.

**ILLUSTRATIVE EXAMPLE 6**

**Township development: Municipality acts as principal**

**Background information:**
Municipality A budgeted R10 million for its own township development project. The project involves the erection of several townhouses and supporting infrastructure in a newly proclaimed township within its jurisdiction. The townhouses will be marketed to middle class purchasers. Municipality A will sell the townhouses for a total of R12 million. Municipality A receives a municipal infrastructure grant of R8 million from National Treasury to assist it to develop the township.

**Answer:**
The R8 million received is a “grant” and the receipt is subject to VAT at the zero rate as National Treasury does not receive any goods or services in return for the payment. The sale of townhouses constitutes taxable supplies and therefore Municipality A will have to charge VAT at the standard rate on the sale of the units. The VAT-inclusive costs of developing the townhouses may be deducted as input tax provided the relevant supporting documentation is obtained and retained.

**Municipalities acting as an Agent**
A municipality generally acts as an agent when assisting the provincial government to deliver on its mandate. The following situations demonstrate the circumstances in which a municipality acts an `agent' for a province (including a provincial department):
The actual fees charged by the municipality, as agent on behalf of the provincial government in respect of the underlying supply, will not be subject to VAT. The reason for this is that the provincial government is a “public authority” and as a rule may not register for VAT, or charge VAT on goods or services supplied (unless that public authority is notified by the Minister to register for VAT).

The municipality must account for output tax at the standard rate of 15% (with effect from 1 April 2018) on the commission or agency fee and any other charge made for the supply of the agency services (for example, issuing licenses or permits on behalf of the provincial government).

Any VAT charged by the municipality on the agency fee/commission and any other elements of consideration charged (or cost recoveries made) by the municipality cannot be deducted as input tax by the provincial government as it is not a vendor. The VAT charged by the municipality therefore becomes part of the overall costs incurred by the provincial government for providing the goods or services and should be budgeted for accordingly.

ILLUSTRATIVE EXAMPLE 7
Vehicle licence: Municipality acts as agent for provincial government

Background information:
Province Y concludes an SLA in terms of which Municipality X is appointed to collect vehicle licence fees and to issue vehicle licences on its behalf.

Additional information:
- Province Y enters into a SLA in terms of which Municipality X is appointed to collect vehicle licence fees and to issue vehicle licences on its behalf.

Answer:
- The vehicle licence fees charged by Municipality X, as agent on behalf of Province Y, are not in respect of a taxable supply. The agency fee charged by Municipality X to Province Y for collecting the vehicle licence fees and issuing the licences on Province Y...
VAT FOR THE GOVERNMENT SECTOR

Y’s behalf is a taxable supply at the standard rate. Municipality X will be entitled to deduct input tax in respect of any goods or services acquired to perform the agency services, (for example, computer systems maintenance, stationery, office rental, electricity etc).

- The vehicle licence fees are charged by Municipality X as agent and do not constitute consideration charged in respect of a taxable supply. As Province Y is not a vendor, any VAT incurred on Municipality X’s agency fee and any expenses incurred by Municipality X in acquiring goods or services on Province Y’s behalf relating to the vehicle licence activity, cannot be deducted as input tax. The VAT is therefore a cost to Province Y.

ILLUSTRATIVE EXAMPLE 8

Provincial administration building development: Municipality acts as agent

Background information:
Province B engages Municipality A to act as its agent in overseeing and managing the activity of erecting a new provincial administration building. Municipality A charges a 15% VAT-inclusive fee (R460 000) based on the total development cost of R10 million.

Municipality A also pays the following expenses on Province B’s behalf:
- Roads, water and other infrastructure R2 990 000 (including VAT)
- Construction cost of provincial administration building R5 750 000 (including VAT).

Provincial government employee salaries and wages R2 000 000 (no VAT included)

Answer:
Municipality A must account for output tax of R60 000 in respect of the R460 000 VAT-inclusive agency fee charged to Province B for overseeing and managing the project on Province B’s behalf.

Municipality A is only entitled to deduct input tax on its own expenses incurred that relate to its oversight and management of the project on behalf Province B. The VAT incurred in respect of the development of the provincial administration building as well as the agency fee charged by Municipality A is a cost to Province B. The VAT charged will also be a cost for Province B.
if the land for the development was acquired from a vendor. If the land was acquired from a non-vendor, Province B (being part of government) will be exempt from transfer duty.

In this example, if Municipality A merely disbursed the salaries and wages from funds advanced by Province B, it does not constitute part of the consideration charged for the agency services of Municipality A.

**Important reminders**

Had Province B requested Municipality A to use its own employees to carry out the development, the salaries and wages paid by Municipality A to its own employees cannot be regarded as a disbursement on behalf of Province B, but an expense incurred in rendering a service. This is because the provision of labour by Municipality A would constitute a taxable supply and the consideration charged would attract VAT at the standard rate (although the consideration is determined on the basis of a recovery of Municipality A’s “costs”).

Had this been the case, the “cost” of R2 000 000, in this case represents the actual salaries and wages paid by Municipality A to its own employees, it would have to charge an additional amount of R300 VAT (for example 15% × R2 000 000). This amount must appear on the tax invoice that must be issued to Province B, in addition to the agency fee. If the municipality fails to raise output tax on the salary costs charged, the output tax which has to be declared on the supply would be a cost to Municipality A instead of Province B as the amount charged would be deemed to be inclusive of VAT.

This example illustrates how important it is to carry out the budgeting exercise correctly for projects of this nature.

**Taxable supplies**

Municipalities have the right, under section 156(1)(a) of the Constitution, to administer certain local government activities listed in Part B of Schedule 4 and Part B of Schedule 5 to the Constitution (see attachment B) - Municipalities are therefore involved in making many different types of supplies.

For the purposes of completing the VAT 201 return and accounting for VAT, it is necessary for a municipality to split the receipts in connection with its activities into:

1. standard rated taxable supplies (electricity, water, refuse removal and supplies which are taxable at the standard) – see Attachment A for examples);
2. zero-rated supplies (for example, municipal rates charges and grants received for the purposes of making taxable supplies); and
3. exempt supplies (rental of dwellings and transport of fare-paying passengers by road or rail).

Please note that transactions, such as, for example, fines and penalties, do not arise because of `enterprising’ activities of municipalities. In addition, it is not a service rendered by a municipality. These transactions arise simple because a municipal law or by-laws have been violated. A violation of laws is not an `enterprising’ activity nor is it a service rendered by a municipality. Hence there will not be VAT implication for these transactions.

Hence receipts in respect of exempt supplies and other non-taxable receipts must be added together and reported as a single amount in Block 3 of the VAT 201 return.

**INPUT TAX**

**Introduction**

For a municipality to deduct input tax, goods or services must be acquired for consumption, use or supply in the course of making taxable supplies. No input tax may be deducted in respect of goods or services acquired for the purposes of making exempt or other non-taxable supplies.

Input tax may therefore be deducted on acquisitions for taxable purposes where:

- VAT is charged at the standard rate by a VAT-registered supplier of goods or services;
- VAT is paid on the importation of goods into the Republic; or
- second-hand goods situated in the Republic (including fixed property) are acquired under a non-taxable supply from a resident of the Republic.

There are, however, many conditions to be met in addition to the above, namely:

- the recipient must be in possession of the relevant documentation, for example, a tax invoice or a bill of entry (together with a receipt issued by Customs for the payment of
the VAT on importation, the EDI Status 1 Release Message and, the statement issued by the agent under section 54(3)(b)(ii) read with section 54(2A));

- where goods or services are acquired only partly for the purpose of making taxable supplies, an apportionment of input tax must be made; and
- no input tax may be deducted where the goods or services are acquired for making exempt or other non-taxable supplies, or where the input tax is specifically denied (motor car, entertainment and subscriptions).

There are several other limitations and conditions that apply when second-hand goods are acquired under a non-taxable supply in order to claim the `notional' input tax, for example:

- the recipient must retain the prescribed and relevant supporting documents, such as, name and address of the supplier, the quantity supplied and the date when it was supplied. If the supplier is an individual, an ID number is required. If the supplier is a company, then the ID number of the natural person representing the company must be available. The name of company, it’s registration number and details of its representative must be verified.
- the deduction is limited to the extent that a monetary payment is made for the supply;
- the input tax deduction is further limited to the lower of cost and the open market value of the second-hand goods; and
- the second-hand goods constitute fixed property.

1. **acquired before 10 January 2012** – the input tax could be deducted to the extent that payment for the property is made and after the transfer duty had actually been paid or any applicable exemption from transfer duty had been granted. As municipalities are exempt from transfer duty, the deduction would have been limited to the transfer duty that would have been payable had the exemption not applied;

2. **acquired on or after 10 January 2012** – the input tax may only be deducted to the extent that payment for the property is made, provided the time of supply rule under the VAT Act has occurred. The time of supply is the earlier of the date that any consideration was paid, or that the property was transferred in the deeds register.

**Direct attribution vs. apportionment**

In establishing the amount of input tax that may be deducted, the principle of direct attribution is used. Therefore, where goods or services are acquired:
• wholly for making taxable supplies, the full amount of VAT incurred is deducted as input tax;
• wholly for making exempt supplies or other non-taxable purposes, no input tax can be deducted because the VAT is directly attributable to the municipality’s non-enterprise activities; and
• for making both taxable and exempt supplies or other non-taxable purposes (commonly referred to as “mixed supplies”), only a fair and reasonable proportion of the VAT incurred may be deducted as input tax.

Direct attribution
If the acquisition of goods or services can be identified as being exclusively or wholly for a particular purpose, the VAT incurred on those supplies can either be deducted in full (wholly for taxable supplies), or input tax may be not be deducted at all (exempt or other non-taxable purposes).

In applying the concept of direct attribution, the manner in which expenses are incurred, and the actual application of the goods or services in the business, must be examined.

In a case where a vendor makes only taxable supplies, this is a simple exercise in that the VAT incurred will usually be exclusively for taxable supplies, and the input tax can be deducted in full.

However, in most cases, a municipality will make taxable, exempt and out-of-scope supplies. This means that when a municipality incurs an expense, it must first establish if the expense is directly attributable to exempt or other non-taxable supplies or to taxable supplies before applying an apportionment ratio to deduct input tax.

The apportionment of input tax is only applicable to expenses that cannot be directly attributed as explained above. In other words, apportionment only applies where the expense is incurred for mixed-use purposes (that is, taxable and non-taxable purposes).

The process of applying direct attribution can be facilitated by the way in which a municipality organises its different activities into divisions or business units. For example, where the individual divisions or business units have control over their own budgets and expenditure
decisions, and if they are structured to exclusively account for taxable or exempt activities in each division, it is much easier to apply direct attribution.

**ILLUSTRATIVE EXAMPLE 9**
**Direct attribution: Taxable supplies**

**Background information:**
ABC Municipality buys a truck costing R345 000 (including VAT) for the removal of garbage from the properties of all owners residing within its demarcated area. The removal of garbage qualifies as an “enterprise” activity, which is a taxable activity.

**Answer:**
As the truck was acquired exclusively for making taxable supplies, the expense is wholly attributable to making taxable supplies and ABC municipality can therefore deduct the full amount of VAT charged as input tax (R345 000 × 15 / 115 = R45 000).

**ILLUSTRATIVE EXAMPLE 10**
**Direct attribution: Exempt supplies**

**Background information:**
ABC Municipality runs a fleet of buses which is used exclusively to provide local public passenger transport. The municipality imports a new bus for the purposes of its passenger transport business and pays an amount of R45 000 VAT on the value of the bus on importation.

**Answer**
As local transportation of fare-paying passengers in a bus is exempt from VAT under section 12(g), the VAT paid is wholly attributable to making exempt supplies. ABC Municipality therefore cannot deduct any VAT as input tax in respect of the VAT paid on the importation of the bus.
ILLUSTRATIVE EXAMPLE 11
Direct attribution vs. apportionment

Background information:
On 1 November 2015, ABC Municipality rents a two-storey building under a single lease agreement which houses its public passenger transport and municipal rates divisions. The divisions occupy the ground floor and first floor of the building respectively. The divisions utilise the same software which has been implemented across all of ABC Municipality’s different divisions and it receives a single telephone account each month for telephone usage from the building address.

The municipality does not maintain separate cost centres for each division.

Furthermore:
- the lease agreement does not provide for separate rental amounts for each division;
- the cost of the computer software relates to the organisation as a whole; and
- the account for the use of telephones is not billed to each division separately.

Answer:
The public passenger transport division makes only exempt supplies and the municipal rates division makes only taxable supplies. Although the divisions are organised along the lines of wholly taxable and wholly non-taxable activities, ABC Municipality has not arranged its contracts or implemented accounting methods to specifically allocate costs incurred by each division.

ABC Municipality is unable to attribute its expenses wholly to taxable or wholly to exempt supplies.

It follows that ABC Municipality would have to apportion the VAT incurred in relation to these expenses as set out below.
Binding General Ruling (BGR) 4\(^2\) prescribes the specific turnover-based apportionment method to be applied by all municipalities when calculating the amount of VAT incurred that may be deducted in respect of goods or services acquired for mixed purposes. BGR 4 provides guidance as to specific items that must be included in, or excluded from, the formula.

A Municipality must use the turnover-based method of apportionment to determine the amount of VAT to be deducted as input tax on the acquisition of goods or services for a mixed purpose.

The apportionment formula must be applied as follows to determine the amount of input tax:

\[
Y = \frac{a}{(a+b+c)} \times 100
\]

Where:

“\(y\)” = the apportionment percentage/ratio;

“\(a\)” = the value of all taxable supplies (including deemed taxable supplies) made during the period; “\(b\)” = the value of all exempt supplies made during the period, excluding interest earned on funds for day-to-day operations held in for example a current account at a bank; and the sum of any other amounts not included in “\(a\)” or “\(b\)” in the formula, that were received or accrued during the period (whether for a supply or not, for example, income received for out-of-scope supplies).

**Notes:**

The term “value” excludes any VAT component.

In the Formula, “\(c\)” will typically include, but is not limited to, items such as statutory fines, penalties, dividends etc. However, traffic fines are only included in “\(c\)” to the extent that payment has been received by the municipality.

- Exclude from the calculation the value of any capital goods or services supplied, unless supplied under a rental agreement (that is, not an instalment credit agreement).
- Exclude from the calculation the value of any goods or services supplied where input tax on those goods or services was specifically denied under section 17(2).
- The apportionment percentage should be rounded off to 2 decimal places.
- Where the Formula yields a result equal to 95% or more, the full amount of VAT incurred for a mixed purpose may be deducted (the *de minimis* rule).

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\(^2\) BGR 4 – issue 3 – 27 March 2015
The following requirements and conditions apply in determining the amounts to be included in the Formula:

- A grant that is received partly for taxable purposes and partly for non-taxable purposes must be attributed accordingly. For example, if 70% of a grant is for subsidising the taxable supply of water and electricity to customers and 30% is for subsidising the municipality’s exempt public transport business, the grant amount will have to be split into its respective taxable and non-taxable components in accordance with section 10(22). In this example, 70% of the grant amount will be subject to VAT at the zero rate and will be included in “a” in the Formula. The remaining 30% of the grant will be applied for exempt purposes and will be included in “b” in the Formula.

- Notwithstanding any permission which may have been granted by the Commissioner to allow a municipality to account for VAT on the payments basis under section 15(2)(a)(v), the amounts to be included in “a”, “b” and “c” in the Formula for each tax period and for the annual adjustment contemplated are to be calculated on the invoice basis and in accordance with the principles set out in the Accounting Standards Board’s Standard of Generally Recognised Accounting Practice (GRAP) on Revenue from Non-exchange Transactions (Taxes and Transfers), commonly referred to as GRAP 23. In terms of GRAP 23, income from government grants and subsidies is only recognised when the conditions (if any) are met. Grant income will therefore only be included in the Formula to the extent that such funds are reflected in the income statement of the municipality for the financial year concerned.

**ILLUSTRATIVE EXAMPLE 12**

**Application of the turnover-based method of apportionment**

**Background information:**
Municipality A purchases computer software for R460 000 (including VAT). The bank’s apportionment ratio is 60% based on the turnover-based apportionment method. The software is used to administer the supplies of all the taxable and exempt divisions of the municipality.
Answer:
The software is therefore used by the municipality partly for making taxable supplies and partly
for making exempt supplies. In this case, 60% of the VAT incurred on the acquisition of the
computer software (R36 000) may be deducted as input tax.

Calculation: [(R460 000 × 15 / 115) × 60%] = R60 000 × 60% = R36 000

De Minimus Rule: full claim of input tax
The rule is that all input tax may be claimed when the expenses incurred is for, at least, 95%
for the making of taxable supplies. It is likely that a municipality could have incidental exempt
supplies, but the De Minimus rule will allow the municipality to claim all the input tax including
for expenses incurred in relation to exempt supplies.

ILLUSTRATIVE EXAMPLE 13
Application of the de minimis rule

Background information:
Municipality A purchases computer software for R460 000 (including VAT). The municipality’s
apportionment ratio is 96% based on the turnover-based apportionment method. The software
is used to administer the supplies of all the taxable and exempt divisions of the municipality.

Answer:
The software is therefore used by the municipality partly for making taxable supplies and partly
for making exempt supplies. However, since the apportionment ratio is calculated as being
96%, the full amount of VAT may be deducted as input tax. This is because the de minimis
rule (where the ratio is 95% or more) may be applied. As a result, the full amount of R60 000
VAT incurred on the acquisition of the computer software may be deducted as input tax.

Calculation: [R460 000 × 15 / 115] × 100% = R60 000
DENIAL OF INPUT TAX

Entertainment
The denial of input tax in relation to the supply of “entertainment” will not apply to municipalities. A municipality will therefore be able to deduct input tax in relation to the creation or maintenance of those recreational facilities. However, where entertainment goods or services are acquired for hosting an event at sporting or recreational facilities or public amenities, the deduction of input tax must be considered against the provision of section 17(2)(a)(i).

ILLUSTRATIVE EXAMPLE 14
Denial of input tax (entertainment – staff refreshments)

Background information:
ABC Municipality acquires tea and coffee to supply to its staff free of charge.

Answer:
As the provision of tea and coffee falls within the ambit of “entertainment” as defined in section 1(1) and as the municipality does not supply the entertainment for a charge which covers all the direct and indirect costs of providing the entertainment nor equals the open market value thereof, it will not be entitled to deduct any input tax.

ILLUSTRATIVE EXAMPLE 15
Exception to the denial of input tax (entertainment – public recreation facility)

Background information:
ABC municipality incurs expenses (including VAT) to develop a public park that includes amenities, such as swings, slides and other playground facilities, including a sport field, for the entertainment of children. The facilities is made available free of charge to the public.
Answer:
Proviso (v) to section 17(2)(a)(i) allows the municipality to deduct input tax on the entertainment expenses which were incurred to provide the playground and sports facilities, even though it does not supply the entertainment for a charge which covers all the direct and indirect costs of providing that entertainment.

Motor cars
Vendors are not entitled to deduct input tax on the acquisition of a “motor car” as defined in section 1(1) of the VAT Act. This rule applies equally to municipalities. The deduction of input tax is prohibited even in instances when the motor car is acquired by the municipality wholly for purposes of making taxable supplies.

The subsequent sale of the motor car by the municipality will not be subject to VAT.

A municipality may however deduct the VAT incurred on the running and modification costs to the extent that the motor car is used in the course or furtherance of its enterprise. Running costs include the repair, maintenance and insurance expenses of the motor car, while the modification expenses for example, the installation of a canopy or roof rack.

The disallowance of an input tax deduction on the acquisition of a motor car does not apply to foreign donor funded projects. If a municipality is separately registered in respect of a foreign donor funded project, it will be allowed to deduct input tax on the acquisition of a motor car applied in the course or furtherance of that foreign donor funded project.

Metro Police
Police and law enforcement services such as those provided by the South African Police Service (SAPS) are not specifically exempt under section 12. However, as the SAPS is a public authority and may not register for VAT, the same effect of an exemption on the provision of those services is achieved.

Similarly, metropolitan police and traffic control services provided by municipalities are also not exempt under section 12. The difference is that a municipality will normally be registered for VAT and these activities are included in paragraph (a) of the definition of “enterprise”.

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Section 156(1)(a) of the Constitution, a municipality administers municipal roads as well as traffic and parking, which are local government activities listed in Part B of Schedule 4 and Part B of Schedule 5 to the Constitution. It follows that the activities performed by a municipality in connection with metropolitan police and traffic control matters are, by default, taxable “enterprise” activities.

Even though the metro police division of a municipality might not necessarily charge a specific consideration for most of its services, the activities are still regarded as being a part of the municipality’s “enterprise” as a whole. Therefore, any consideration charged in respect of such services will be subject to VAT at the standard rate.

Therefore, income from parking meters which is a charge for street parking, or, for example charges for escorting abnormal vehicles through a city must be declared as standard rated supplies and output tax must be paid thereon. For example, if the metro police division acquires new office furniture, it may deduct input tax to the extent that the furniture is used to make taxable supplies.

Similarly, any taxable supplies made by the municipality to the FDFP will attract VAT at the standard rate and the FDFP may deduct input tax in accordance with the rules discussed in this paragraph (subject to the normal documentary requirements for the deduction of input tax).

Change in municipal boundaries

Currently, there are 278 municipalities in South Africa, comprising eight metropolitan, 44 districts and 226 local municipalities.

It is given that boundary of municipal boundaries does change. Section 31 of the Local Government: Municipal Demarcation Act 27 of 1998 and the Structures Act deal with the legal, practical and other consequences when a municipality is wholly or partially incorporated in or combined with the area of another municipality.

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3 VAT treatment of municipalities affected by changes to municipal boundaries. BGR 39(issue 2) – 26 July 2018
There are two possibilities:

1. In the case of the transfer of all assets, liabilities, rights and obligations of an existing municipality (transferor) to a superseding municipality (transferee) because of a municipal boundary change, such municipalities are deemed to be one and the same person for the purposes of section 8(28), provided that such municipalities are merged into a single municipality.

2. In the case of the transfer of only some of the assets, liabilities, rights and obligations because of the municipal boundary change, where the municipalities concerned continue to exist as separate persons, then the existing municipality (transferor) is deemed not to have made a supply to the superseding municipality (transferee) in that regard.

The VAT outcome of these municipal boundary changes at the effective date of municipal boundary change are as follows:

- no supply of any goods or services is made by the existing municipality for the purposes of section 7(1)(a), and consequently, there will be no output tax payable by the existing municipality in relation to either on an invoice or payment basis\(^4\);
- no goods or services are acquired by the superseding municipality from the existing municipality, and consequently, the superseding municipality will not be allowed to deduct input tax,
- no change of use adjustments under section 18 will be allowed to, or required by, either the existing municipality or the superseding municipality;
- an output tax or input tax adjustment may be required in situations wherein the existing and superseding municipalities do not account for VAT on the same accounting basis;
- Exit VAT will not apply to the existing municipality upon its disestablishment and subsequent deregistration for VAT purposes unless any goods or rights capable of assignment, cession or surrender are not transferred to the superseding municipality because of the municipal boundary change, in which case, exit VAT shall only apply to that extent;

\(^4\) Section 16 (4) of the VAT Act
• any valid tax invoice, debit or credit note or other prescribed document that has been issued in the name of the existing municipality, may be used as acceptable documentary proof for the purposes of deducting input tax or other allowable deduction in the name of the superseding municipality for a period of six months after the effective date of the municipal boundary change, provided such deduction has not previously been allowed to the existing municipality;

• for the purposes of calculating the superseding municipality’s apportionment percentage based on municipal turnover as per BGR 4\textsuperscript{5} symbols (a), (b) and (c) shall be the aggregate of the values of those symbols for the existing and superseding municipalities for the financial year concerned; and

• as a superseding municipality becomes the successor in law of the existing municipality in the event of a complete merger, the superseding municipality is liable to account to SARS for any VAT liability or outstanding VAT returns in relation to the activities of the existing municipality that arose before the effective date of the municipal boundary change.

The above guidance and clarity on the VAT treatment of supplies made by municipalities.

**Foreign donor funded project (FDFP)**

A FDFP is a separate `person’ for VAT purposes.

It is a project established to give effect to an international donor funding agreement that is binding on the Republic, under section 231(3) of the Constitution. Such agreements provide that any donated funds cannot be used to pay for any taxes imposed under South African Law.

The person appointed by the foreign donor as being responsible for administering the international donor funding agreement and carrying out the project may register for VAT so that any VAT incurred for the purposes of the project can be refunded through the VAT system as “input tax”.

FDFP can be administered by a public authority or municipality, the FDFP itself qualifies to be registered for VAT regardless of the VAT status of the entity that manages its activities.

\textsuperscript{5} BGR 4 – issue 3 – 27 March 2015
Any input tax deductions in this regard are limited to the VAT incurred on goods or services acquired by the FDFP directly in connection with the implementation of the project. Moreover, input tax relating to the acquisition of motor cars and entertainment may be deducted by FDFPs, even though they are generally disallowed for other vendors. This special provision does not entitle the public authority or municipality that administers or implements the project to deduct input tax on its normal VAT-inclusive capital and operating costs.

In light of the fact that the FDFP and public authority or municipality (as the case may be) are separate persons, both parties are required to account for output tax on supplies made to each other. The deduction of input tax by the parties concerned on such supplies will depend on the status of the entity. For example, a public authority is usually not a vendor and will not deduct input tax nor charge VAT on any supplies made.

In the case of a municipality, the rules as discussed in this brief, the deduction of input tax and the declaration of output tax will apply. For example, if any goods or services are supplied by the FDFP, the deduction of input tax by the municipality will depend on whether or not the goods or services are acquired for taxable purposes (subject to the normal documentary requirements for the deduction of input tax).
ATTACHMENT A – EXAMPLES OF “ENTERPRISE” ACTIVITIES

The following is a list of supplies or income from supplies made by municipalities which are subject to VAT at the standard rate:

- The supply of electricity, gas or water.
- The drainage, removal or disposal of sewage or garbage.
- Upgrading/building of roads.
- Operating hospitals as principal.
- Abattoirs.
- Farming and forestry, for example the sale of trees or wood derived from trees removed from municipal owned forests.
- Parking grounds and garages.
- Produce markets.
- Township development.
- Escorting of abnormal vehicles by Metro Police.
- Airports.
- Quarries and the sale of sand.
- Cement-making.
- Caravan parks, pleasure and holiday resorts.
- Nurseries/hiking trails.
- Brickyards.
- Liquor sales.
- Provision of computer services.
- Game farms.
- Dog tax (fees).
- Cattle pens and auction facilities.
- Fee/refunds/commission received.
- Royalties.
- Library services.
- Museums and heritage buildings.
- Fire brigade services (fees).
- Provision of bus/taxi shelters and advertising services supplied in this regard.
- Issuing of licences or permits as principal.
- Entrance fee to recreational facilities.
- Parks and recreational services.
- Connection and reconnection of electricity, water or gas (fees).
- By-products sales.
- Fees for making photostat copies of documents.
- Inspection/re-inspection (fees).
- Meter reading services.
- Signage and advertising.
- Trading (fees).
- Weighbridge.
- Industrial effluent/treatment effluent – sales.
- Subdivisions/zoning/re-zoning (fees).
- Recoveries of infrastructure maintenance.
- Removal of restrictions (for example, in a title deed in respect of a building site).
- Encroachment (fees) (for example, on the purchase or letting of a roadway/path which cuts through an erf).
- Burial fees/grave sales/cremation fees/cemetery fees.
- Filming (fees).
- Informal trading levy/trade licence.
- Recoupment: telephone/parking from staff.
- Banana ripening.
- Salvage items.
- Advertising.
- Roadworthy application/certificate.
- Fishing permit.
- Boat registration.
- Licensing and regulation: trading.
- Duplicate certificates.
- Selling of animals, birds, fish, trees or plants.
- Street frontage administration fee.
- Towing fees.
- Letting of commercial buildings, for example, offices, halls or shops.
- The supply of accommodation in a hostel or boarding establishment (commercial accommodation).
- Actual services rendered by one municipality to another municipality.
- Actual or deemed services rendered to a municipal entity.
• Intra-municipality service charges (only where the division of the municipality is registered separately for VAT purposes).
• Agency fees for acting as collecting and issuing agents for Province (for example, motor licences).
ATTACHMENT B – EXTRACTS FROM THE NATIONAL CONSTITUTION

The National Constitution

SCHEDULE 4
Functional Areas of Concurrent National and Provincial Legislative Competence

Part B

The following local government matters to the extent set out in section 155(6)(a) and (7):

- Air pollution
- Child care facilities
- Firefighting services
- Municipal airports
- Municipal health services
- Building regulations
- Electricity and gas reticulation
- Local tourism
- Municipal planning
- Municipal public transport
- Municipal public works only in respect of the needs of municipalities in the discharge of their responsibilities to administer functions specifically assigned to them under this Constitution or any other law
- Pontoons, ferries, jetties, piers and harbours, excluding the regulation of international and national shipping and matters related thereto
- Stormwater management systems in built-up areas
- Trading regulations
- Water and sanitation services limited to potable water supply systems and domestic wastewater and sewage disposal systems


**SCHEDULE 5**

Functional Areas of exclusive Provincial Legislative Competence

**Part B**

The following local government matters to the extent set out for provinces in section 155(6)(a) and (7):

- Beaches and amusement facilities
- Billboards and the display of advertisements in public places
- Cemeteries, funeral parlours and crematoria
- Cleansing
- Control of public nuisances
- Control of undertakings that sell liquor to the public
- Facilities for the accommodation, care and burial of animals
- Fencing and fences
- Licensing of dogs
- Licensing and control of undertakings that sell food to the public
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Acts
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