PIETER VAN DER ZWAN
& ASSOCIATES
TAX & IFRS ADVISORS

+27 83 417 5904
pieter@pvdz.co.za
www.pvdz.co.za

VAT: Separation of supplies into parts

Vendors who make supplies that consist of more than one part may be required to separate the supply into its parts and determine the VAT implications of each part separately in certain circumstances. Section 8(15) of the VAT Act governs when a supply should be separated into its components in this manner. The tax court recently considered the application of this provision in *Case No: VAT 1558*.

Where a supply consists of parts that would be subject to different VAT rates if consideration had been charged separately for each part, the VAT Act requires that such parts be treated as separate supplies (section 8(15) of the VAT Act). This article briefly reviews a recent tax court case (Case No: *VAT 1558)* where the application of this provision was considered.

Facts

The taxpayer manufactures and distributes drinking beverages in South Africa in terms of an exclusive distribution agreement with offshore brand owners. It uses the trademarks and intellectual property of the brand owners. The brand owners invests in advertising and promotion (A&P) to build and maintain their brands. The taxpayer supplies an A&P service to the brand owners for a fee. The A&P service includes expenditure in relation to promotional products. The invoice to the brand owners does not distinguish between a fee for the service and a fee for these promotional products (goods).

Dispute

SARS raised additional VAT assessments on the basis that a portion of the A&P fee related to a separate supply of goods and could not be zero-rated in terms of section 11(2)*(l)* of the VAT Act, which applies to services rendered to non-residents. The taxpayer's position was that this provision can only be applied to different, independently cognisable goods or services supplied together when such supplies can sensibly be supplied separately.

Judgment and analysis

Section 8(15) reads:

> 'For the purposes of this Act, where a single supply of goods or services or of goods and services would, if separate considerations had been payable, have been charged with tax in part at the rate applicable under section 7 (1)(a) and in part at the rate applicable under section 11, each part of the supply concerned shall be deemed to be a separate supply.'

Savage J's analysis of section 8(15) of the VAT Act was that the focus of the enquiry in terms of this provision is whether separate considerations could have been payable in respect of parts of a composite supply. In making this assessment, the commercial reality and economic nature of the transaction must be taken into account. There is however no explicit requirement that a notional separation of a supply into parts should avoid an artificial dissection of the supply if cognisable goods or services for which separate considerations could have been payable can be identified.

Despite a caution against this by SARS' counsel, Savage J referred to a number of cases from the UK and New Zealand where the courts dealt with the distinction between composite and mixed supplies. The relevance of the caution against using foreign authorities was acknowledged though as it was noted that only one of these cases dealt with a deeming provision (*Auckland Institute of Studies Ltd v CIR*) and that particular deeming provision was distinguishable from the deeming rule in section 8(15) of the VAT Act.

The evidence provided by the taxpayer's financial controller indicated that it was possible to determine the cost of the promotional product supplied and express this as a percentage of the total fee charged for the A&P service. The fact that section 8(15) is a deeming provision means that it deems something to be when in fact it is not so. It was held that although the supply of promotional goods was only facet of the supply, the fact that it was possible to notionally separate the consideration for A&P services meant that the deeming provision in section 8(15) applied and this component of the supply had to be viewed separately. As a result, it was found that this deemed separate supply did not qualify for the zero-rating.

It is submitted that this judgment suggests that the requirements of section 8(15) should arguably be interpreted more narrowly than those considered in foreign cases, which are often considered when determining whether a supply is a mixed or composite supply.