

BINDING GENERAL RULING (VAT) NO: 10

DATE: 28 March 2012

ACT : VALUE-ADDED TAX ACT, NO. 89 OF 1991 (the VAT Act)
SECTION : SECTION 1 – DEFINITION OF “INPUT TAX” AND SECTION 17(1)
SUBJECT : APPORTIONMENT METHODOLOGY TO BE APPLIED BY CATEGORY B MUNICIPALITIES

1. Purpose

The purpose of this binding general ruling is to prescribe the apportionment method, as contemplated in section 17(1), which Category B¹ municipalities must use to calculate the amount of value-added tax (VAT) to be allowed as input tax in respect of the acquisition of goods or services for a mixed purpose.²

2. Background

A municipality must levy VAT at the standard rate, under section 7(1)(a), on all supplies made in the course or furtherance of carrying on an enterprise which are not specifically subject to VAT at the rate of zero percent under section 11 (for example, grants, municipal property rates etc.), exempt from VAT under section 12 (for example, the transportation of passengers in a bus, the rental of dwellings etc.), or fall outside the scope of VAT (for example, dividends, statutory fines and penalties).

In this regard the [VAT 419 - Guide for Municipalities](#) sets out the application of the VAT Act in respect of, amongst others, supplies made by and to municipalities.

3. The law and its application

The statutory framework [i.e. the definition of “input tax” in section 1] requires the principle of “direct attribution” to be applied, in that VAT must be attributed in the first instance according to whether it is wholly related to the making of taxable supplies or wholly to the making of exempt or out of scope supplies. VAT that cannot be attributed must be allocated to a mixed purpose.

¹ A “Category B Municipality” is a ‘local municipality’ that shares municipal executive and legislative authority, i.e. the authority to administer and make rules, in its area with a Category C Municipality, being a ‘district municipality’, within whose area it falls.

² For purposes of this document the acquisition of goods or services partly for the purpose of consumption, use or supply in the course of making taxable supplies and partly for another intended use will be referred to as a “mixed purpose”.

A municipality, being a vendor, may deduct the full amount of the VAT incurred on the acquisition of goods or services, as input tax, where the acquisition is wholly for the purpose of consumption, use or supply in the course of making taxable supplies and may not deduct the VAT incurred on the acquisition of goods or services, as input tax, where the acquisition is for the purpose of consumption, use or supply in the course of making wholly exempt or wholly out of scope supplies³. The VAT incurred on the acquisition of goods or services where the acquisition is for a mixed purpose may also be deducted as input tax to the extent determined in accordance with an approved apportionment method as contemplated in section 17(1).

4. Ruling

- 4.1 Category B municipalities must use the turnover-based method of apportionment to determine the amount of VAT to be deducted as input tax in respect of the acquisition of goods or services for a mixed purpose.
- 4.2 The apportionment formula (the Formula) to be applied to determine the amount of input tax contemplated in paragraph 4.1 is as follows:

$$y = \frac{a}{(a + b + c)} \times \frac{100}{1}$$

Where:

- “y” = the apportionment percentage;
- “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; and
- “c” = the sum of any other amounts not included in “a” or “b” in the formula, which were received or which accrued during the period (whether in respect of a supply or not, for example, income received in respect of out of scope supplies).

Notes:

1. The term “value” excludes any VAT component.
2. In the Formula, “c” will typically include, but is not limited to, items such as dividends and statutory fines (if any).
3. Exclude from the calculation the value of any capital goods or services supplied, unless supplied under a rental agreement/operating lease (that is, not a financial lease⁴ or instalment sale agreement).
4. Exclude from the calculation the value of any goods or services supplied where input tax on those goods or services was specifically denied in terms of section 17(2).
5. The apportionment percentage should be rounded off to 2 decimal places.
6. 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).

³ An out of scope supply refers to a supply that is made by a municipality that is neither in the course or furtherance of that municipality’s enterprise nor is it an exempt supply. This term is also synonymous with the term “non-supply”, for example dividends and statutory fines.

⁴ Means as defined in paragraph (b) of the definition of “instalment credit agreement” in section 1.

- 4.3 Category B municipalities, for purposes of determining the amounts to be included in the Formula, are required to comply with the following arrangements:
- 4.3.1 A grant that is received for purposes of making mixed supplies must be attributed accordingly. For example, if 30% of a grant is for subsidising the municipality's public transport business, which is an exempt supply, and 70% is for subsidising the supply of water and electricity to customers, which is a taxable supply, the grant must be attributed in terms of section 10(22). Therefore, 30% of the grant will be applied for exempt supplies and will therefore be included in "b" in the Formula, and the remaining 70% will be subject to VAT at the zero rate and will therefore be included in "a" in the Formula.
- 4.3.2 Category B municipalities are required to recalculate the apportionment percentage based on the actual attribution of all grants, within three months after their financial year end, which may result in an increase or decrease to input tax. A Category B municipality that is unable to perform the recalculation within the stipulated timeframe must approach the South African Revenue Service (SARS) to request an extension.
- 4.3.3 The assignment of functions by national or provincial government falls within the ambit of the "enterprise" activities carried on by that municipality, provided that the activity does not fall within the ambit of section 12. Any consideration charged, must be included in "a" in the Formula. Any payment received as a result of the national or provincial government providing financial assistance to enable the Category B municipality to carry out the assigned activity, which is a taxable supply, is regarded as a "grant" as defined in section 1 and must be included in "a" in the Formula.
- 4.3.4 The activities in respect of which Category B municipalities are appointed as agent by provincial government do not fall within the ambit of the enterprise carried on by Category B municipalities. Only the amount charged in respect of the taxable supply of such agency service to provincial government must be included in "a" in the Formula.
- 4.3.5 Interest earned on, for example, investing surplus funds or overdue accounts, must be included in "b" in the Formula.
- 4.4 The VAT incurred and paid for directly on the supply of goods or services associated with provincial government mandates, referred to as "unfunded mandates", is regarded as being incurred in the course or furtherance of that municipality's enterprise, provided that the provincial government mandate activity is not exempt in terms of section 12. The VAT may be deducted in full where incurred wholly for purposes of use, consumption or supply in the course of making taxable supplies or deducted in accordance with the Formula if incurred for mixed purposes, subject to sections 16(2), 16(3), 17 and 20.
- 4.5 Category B municipalities are required to exclude the value of the supply of capital goods or services (unless supplied under a rental agreement/operating lease) and the value of the supply of goods or services where input tax was specifically denied for the apportionment calculation. The value of all other taxable supplies, exempt supplies and non-supplies must be included in the Formula.
- 4.6 The Commissioner may, on written application, consider excluding extraordinary income which may create a distortion in the Formula. The written application for a VAT ruling in terms of section 41B, must be submitted to the SARS Branch Office where the municipality is registered.

5. Period for which this ruling is valid

This ruling is a binding general ruling issued in accordance with section 76P of the Income Tax Act, No. 58 of 1962, as made applicable to the VAT Act by section 41A. This binding general ruling is valid until 30 June 2016.

Any ruling issued to Category B municipalities approving a method of apportionment other than that which is confirmed in this ruling, is hereby withdrawn. The effective date of withdrawal is 1 July 2012. This ruling is effective from 1 July 2012 until it is withdrawn, amended, the relevant legislation is amended or a decision of the courts differ materially from this ruling.

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