An analysis of the factors that influence the South African VAT treatment of corporate social responsibility expenditure

D. M. Pretorius
21095256

Mini-dissertation submitted in partial fulfilment of the requirements for the degree *Magister Commercii* in South African and International Taxation at the Potchefstroom Campus of the North-West University

Supervisor: Ms. M. Lubbe

May 2014
ACKNOWLEDGEMENTS

Firstly, I would like to thank our heavenly Father, for everything is possible for those who believe.

Furthermore I would like to thank the following people for their contributions to the completion of this mini-dissertation:

- My study leader, Melissa Lubbe, for her guidance, support and advice.
- David Levey, for his conscientious editing.
- My family and friends, for the continued support and love, without which this study would not have been finished.
ABSTRACT

Corporate Social Responsibility (“CSR”) as a business approach and corporate strategy has recently been added to the agenda of big and small businesses. The Johannesburg Stock Exchange Limited (“JSE”) requires of listed companies to disclose in their annual financial statements whether they have complied with King III (2009) or to explain as to why they have not. King III (2009) lays down the principle that a company is not only a profit making institution, but should also be a responsible citizen of the country. Companies are therefore moving toward becoming corporate citizens. Corporate citizenship is about integrating corporate responsibility into core business strategies, while at the same time adding value to shareholders and stakeholders. These corporate citizens are expending more and more money on their CSR objectives in the form of CSR expenditure.

The purpose of this research study is to provide an analysis of the factors that influence the South African value-added tax (“VAT”) treatment of CSR expenditure. In general, the principles in the Warner Lambert (2003) case can be applied to such expenditure under the Value-Added Tax Act (89 of 1991) (“VAT Act”), in the sense that the expense being incurred for income tax purposes in the production of income will normally also be incurred “in the course or furtherance of an enterprise” for VAT purposes.

The methodology used to meet the set objectives was that of legal interpretative research, specifically doctrinal. It was used to identify how the income tax and VAT legislation is applied on overhead expenditure, specifically CSR expenditure. The principles in the South African VAT legislation, specifically relating to the input tax deduction, were compared to the international VAT system to determine whether principles are similar and foreign judgements therefore reliable. A critical analysis was thereafter performed on South African and international case law, specifically European Court Judgements (“ECJ”) judgements, relating to the deductibility of input tax.

The findings are that CSR expenditure may be seen as an overhead cost to a business and furthermore as a tool with which financial benefits can be created for a company if utilised correctly. It was determined that the factors that influence the South African
VAT treatment of CSR expenditure were whether a supply made for no consideration, specifically CSR expenditure, was made in the course or furtherance of an enterprise and whether the CSR expenditure incurred could be proven to have a direct or immediate link to the making of taxable supplies in the course or furtherance of the vendor’s enterprise.
KEYWORDS

- Corporate Social Responsibility
- Consideration
- Enterprise
- Exempt supply
- Input tax
- Overhead
- Value-added tax
- Vendor
# TABLE OF CONTENTS

ACKNOWLEDGEMENTS .................................................................................................................. ii

ABSTRACT ........................................................................................................................................... iii

KEYWORDS .......................................................................................................................................... v

TABLE OF CONTENTS ................................................................................................................... vi

ABBREVIATIONS .................................................................................................................................. x

CHAPTER 1 ............................................................................................................................................. 1

INTRODUCTION ................................................................................................................................. 1

1.1 Background ................................................................................................................................. 1

1.2 Problem statement ...................................................................................................................... 4

1.3 Research objectives ................................................................................................................... 4

1.4 Research design and methodology ............................................................................................ 5

1.4.1 Research design .................................................................................................................... 5

1.4.2 Research methodology .......................................................................................................... 5

1.5 Delineations and inherent research limitations of the study ..................................................... 6

1.5.1 Delineations ........................................................................................................................ 6

1.5.2 Inherent limitations .............................................................................................................. 6

1.6 Chapter outline .......................................................................................................................... 6

CHAPTER 2 ......................................................................................................................................... 8

THE NATURE OF CORPORATE SOCIAL RESPONSIBILITY EXPENDITURE ................................................................................................................................. 8

2.1 Introduction .................................................................................................................................. 8

2.2 Overhead expenditure ................................................................................................................ 8

2.3 CSR ........................................................................................................................................... 9

2.3.1 Introduction to CSR ............................................................................................................... 9
CHAPTER 4 .............................................................................................................................................. 36

A CRITICAL ANALYSIS OF SOUTH AFRICAN AND INTERNATIONAL CASE LAW REGARDING THE INPUT TAX DEDUCTIBILITY OF CSR EXPENDITURE .................................. 36

4.1 Introduction ......................................................................................................................................... 36

4.2 International characteristics of the South African VAT system ...................................................... 37

4.3 Comparison of principles of the South African and international VAT systems ......................... 39

4.4 Critical analysis of case law ........................................................................................................... 40

4.4.1 Introduction .................................................................................................................................... 40

4.4.2 Basis of selection .......................................................................................................................... 40

4.5 South African case law .................................................................................................................... 41

4.5.1 VAT 711 (2009) .......................................................................................................................... 41

4.5.1.1 Background facts .................................................................................................................... 41

4.5.1.2 VAT Implications ................................................................................................................... 42

4.5.1.3 Application on CSR expenditure .......................................................................................... 42

4.5.2 ITC 1744 (2002) .......................................................................................................................... 43

4.5.2.1 Background facts .................................................................................................................... 43

4.5.2.2 VAT Implications ................................................................................................................... 44

4.5.2.3 Application on CSR expenditure .......................................................................................... 45

4.5.3 CSARS v De Beers (2012) ........................................................................................................... 45

4.5.3.1 Background facts .................................................................................................................... 45

4.5.3.2 VAT implications ....................................................................................................................... 46

4.5.3.3 Application on CSR expenditure .......................................................................................... 47

4.6 International case law ....................................................................................................................... 48

4.6.1 Kretztechnik AG v Finanzamt Linz (2005) .................................................................................... 48

4.6.1.1 Background facts .................................................................................................................... 48

4.6.1.2 VAT Implications ....................................................................................................................... 49
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>B-BBEE</td>
<td>Broad-Based Black Economic Empowerment</td>
</tr>
<tr>
<td>BPR</td>
<td>Binding Private Ruling</td>
</tr>
<tr>
<td>CIR</td>
<td>Commissioner for Inland Revenue</td>
</tr>
<tr>
<td>CSARS</td>
<td>Commissioner for South African Revenue Services</td>
</tr>
<tr>
<td>CSI</td>
<td>Corporate Social Investment</td>
</tr>
<tr>
<td>CSR</td>
<td>Corporate Social Responsibility</td>
</tr>
<tr>
<td>ECJ</td>
<td>European Court Judgements</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>GST</td>
<td>Goods and Service Tax</td>
</tr>
<tr>
<td>IN</td>
<td>Interpretation Note</td>
</tr>
<tr>
<td>ITC</td>
<td>Income Tax Case</td>
</tr>
<tr>
<td>JSE</td>
<td>Johannesburg Stock Exchange Limited</td>
</tr>
<tr>
<td>JSE SRI</td>
<td>Johannesburg Stock Exchange Social Responsibility Index</td>
</tr>
<tr>
<td>King III</td>
<td>King Code of Governance for South Africa 2009 and King Report on Governance for South Africa 2009</td>
</tr>
<tr>
<td>OECD</td>
<td>Organisation for economic co-operation and development</td>
</tr>
<tr>
<td>PBO</td>
<td>Public Benefit Organisation</td>
</tr>
<tr>
<td>PN</td>
<td>Practice Note</td>
</tr>
<tr>
<td>SARS</td>
<td>South African Revenue Services</td>
</tr>
<tr>
<td>SIR</td>
<td>Secretary for Inland Revenue</td>
</tr>
<tr>
<td>Sullivan Code</td>
<td>Global Sullivan Principles for Corporate Social Responsibility</td>
</tr>
<tr>
<td>TA Act</td>
<td>Tax Administration Act</td>
</tr>
<tr>
<td>UK</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>USA</td>
<td>United States of America</td>
</tr>
<tr>
<td>VAT</td>
<td>Value-Added Tax</td>
</tr>
</tbody>
</table>
CHAPTER 1

INTRODUCTION

1.1 BACKGROUND

The South African Companies Act (71 of 2008) does not legally force companies to engage in Corporate Social Responsibility (“CSR”) projects; however, the Johannesburg Stock Exchange Limited (“JSE”) requires listed companies to disclose in their annual financial statements how they have complied with the principles set out in the King Code of Governance for South Africa 2009 and the King Report on Governance for South Africa 2009 (“King III”) (King, 2009a:5). King III (2009) lays down the principle that a company is not only a profit making institution, but should also be a responsible citizen of the country. This engages the social, environmental and economic issues which are in fact the triple context in which companies operate (King, 2009a:11).

South Africa has unique CSR expenditure found nowhere else in the world. Broad-Based Black Economic Empowerment (“B-BBEE”) was implemented in 2003 and has since been a focus point in the South African business environment. Businesses incur expenditure relating to B-BBEE for various reasons, either for their B-BBEE scorecard, marketing purposes and positive corporate image or for an all-purpose philanthropic intent (Acker, 2012:2). B-BBEE is not only applicable to large businesses (Lange Carr & Wessels (“LCW”), 2013); the South African Government has made B-BBEE a responsibility for small to medium businesses as well. This has been achieved by including Socio-Economic Development in the B-BBEE scorecard. Socio-Economic Development is also referred to as Corporate Social Investment (“CSI”) and may include donations to charities or contributions to industry-specific charity based initiatives (Standard Bank, 2008).

Companies that fail to recognise the growing importance of CSR do so at their own peril. CSR should be implemented correctly by recognising the impact of B-BBEE requirements, laws and taxation benefits in a good quality CSR policy that will
provide financial and strategic guidance. The following examples of CSR initiatives are given: providing donations, green initiatives, and development projects for the community as well as healthcare, and financial aid to recognised charities (LCW, 2013).

The income tax deductibility of CSR expenditure was explored in the Warner Lambert SA (Pty) Ltd v Commissioner for South African Revenue Services (“CSARS”) (2003) case. The issue in this case was whether social responsibility expenditure was deductible under the general deduction formula, which consists of Section 11(a) read together with Section 23(g) of the Income Tax Act (58 of 1962). SARS argued that the social responsibility expenditure was not laid out for purposes of trade. The appellant argued that it was closely linked to the income earning structure of the company, and as such it was incurred in the production of income. The court upheld the appellant’s opinion and the expenditure could consequently be deducted. The VAT impact of this type of expenditure should be considered.

Companies may currently find themselves in the position in which they enter into a gratuitous act, for example CSR, which results in questions arising, concerning whether the input tax on this expenditure is deductible (Deloitte, 2010). The definition of input tax in Section 1 of the VAT Act (89 of 1991) requires expenditure to be incurred in the course of making taxable supplies for it to be deductible. The reason for possible non-deductibility is that the gratuitous act does not constitute a supply of goods or services for a “consideration” as defined in Section 1 of the VAT Act (89 of 1991). This results directly from the fact that CSR expenditure is usually carried out for no consideration. When a service is exempt or it is a non-taxable supply, provided at no consideration, no output tax will be imposed in terms of Section 7(1)(a) of the VAT Act (89 of 1991), due to the vendor not incurring the goods and services in the course or furtherance of an enterprise. This results from the fact that a consideration must be charged as a general requirement for an enterprise to be met. This opens the VAT vendor up to risk as seen in the recent judgement in a South African Tax Court case, KCM v Commissioner for South African Revenue Services (“VAT 711”) (2009) case, where it was held that the appellant, an association not for gain, could not claim input tax for items distributed free of charge. This gives further rise to the
concern that input tax may not be deductible where goods or services are supplied by
a VAT vendor for no consideration (PwC, 2010).

The question was also raised by PwC (2010) if the Binding Private Ruling (“BPR”) 053 (SARS, 2003) released on 16 October 2003, had cleared the confusion caused by
the judgement in the VAT 711 (2009) case on whether the input tax should have been
allowed or not. In the BPR 053 (SARS, 2003), SARS ruled that a registered VAT
vendor, which donated a building to a charitable cause (not a VAT vendor), would be
entitled to deduct input tax incurred on the costs surrounding the construction of the
building (SARS, 2003).

The question has been asked whether a vendor will be able to claim input tax paid on
cost related to a typical B-BBEE transaction to acquire or dispose shares, such as due
diligence expenses, costs for corporate finance, legal and advisory fees (KPMG, 2006).
The questionability of this has been opened again with the recent ruling on the
CSARS v De Beers (2012) court case, where it was held that the respondent, De Beers
Consolidated Mines Limited (“De Beers”), could not deduct the input tax on the
imported services as this was not directly linked with their main business. The
CSARS v De Beers (2012) case did not specifically deal with CSR expenditure;
however, it dealt with input tax deductibility. Thus the precedent set by this case
needs to be taken into consideration in respect of the deductibility of input tax. Smuts
(2012) states that the court decision reached in the CSARS v De Beers (2012) case
implies that companies need to be cautious regarding their VAT claims for CSI and
B-BBEE expenditure. Furthermore, it is believed that SARS may reassess its past
views on the input tax deductibility of CSI and B-BBEE expenditure. The argument
advanced in the CSARS v De Beers (2012) case by the respondent, De Beers, was that
the items of expenditure incurred were similar to stock exchange costs, CSI, B-BBEE
expenditure and other closely linked expenditure. SARS did not agree. In their
opinion, the expenses were incurred for two separate businesses. This is due to the
main business of De Beers being mining, and as such, the expenditure was not linked
to the mining business, but rather to the dealing and holding of shares that did not fall
within the definition of an enterprise; therefore the input tax could not be claimed.
This judgement did not follow the approach that was laid down in Income Tax Case
No. (“ITC”) 1744 (2002), being that the expenditure was only preparatory to the conduct of the enterprise and not incurred in the making of taxable supplies.

These recent developments show that further consideration regarding the input tax treatment of overhead expenditure, such as CSR expenditure, is required. Interpretation Note No. 70 ("IN 70") (SARS, 2013b) that was published on 14 March 2013 deals with supplies made for no consideration, but does not provide an in depth view of the facts and circumstances surrounding the specific requirements for the VAT treatment of CSR expenditure. According to BDO (2012), there is uncertainty about whether IN 70 (SARS, 2013b) would answer all the questions regarding the grey area of the VAT treatment of CSR expenditure.

1.2 PROBLEM STATEMENT

From the background provided above, there is uncertainty regarding the VAT treatment of CSR expenditure and further consideration in respect thereof is necessary. It has also been identified from the facts cited in the background that the problem statement below has not been addressed yet by case law or legislation.

The purpose of this study is therefore to provide an analysis of the factors that influence the South African VAT treatment of CSR expenditure.

1.3 RESEARCH OBJECTIVES

The study will be directed by the following research objectives:

i) to explore and understand the nature of overhead expenditure, specifically CSR expenditure (refer to Chapter 2);

ii) to explore the deductibility of input tax on overhead expenditure, specifically CSR expenditure (refer to Chapter 3);

iii) to critically analyse VAT legislation in relation to South African case law regarding the treatment of overhead expenditure in general and CSR expenditure specifically (refer to Chapter 3 and Chapter 4);
iv) to evaluate the VAT treatment of overhead expenditure, specifically CSR expenditure in light of foreign case law (refer to Chapter 4);

v) to make conclusions and recommendations on the factors that influence the South African VAT treatment of CSR expenditure (refer to Chapter 5).

1.4 RESEARCH DESIGN AND METHODOLOGY

1.4.1 Research design

This study will use a non-empirical approach (Mouton, 2011:179). A literature review will be performed to identify the problem statement. Such a review is the selection of available documents in published and unpublished format on the topic which contains the information, data, ideas and evidence written from a particular standpoint to satisfy certain aims or express specific views relating to the nature of the topic and the investigation thereof, as well as the effective evaluation of these documents relating to the research (Hart, 1998:13). A literature review has been chosen due to the sources being in the form of documents, texts and websites (Mouton, 2011:180). The said review will be utilised to provide the data on which the legal interpretative research can be performed as the research method of this study.

1.4.2 Research methodology

The research method will be a legal interpretative research that is a form of normative research, specifically doctrinal. Doctrinal research may be explained as a research methodology which gives a systematic exposition of the rules presiding over a particular legal category, analyses the relationships between rules and explains areas of complexity. Such research is a library based undertaking focused on reading and conducting an intensive scholarly analysis (McKerchar, 2008). This method will be used to identify how the income tax and VAT legislation is applied regarding overhead expenditure, specifically CSR expenditure. In this study the VAT Act (89 of 1991) in general will be examined and supplies made for no consideration will be closely looked at. The general deduction formula consisting of Section 11(a) read together with Section 23(g) in the Income Tax Act (58 of 1962) will also be closely scrutinised, as there is no specific section in the income tax or VAT legislation that specifically allows the deduction of CSR expenditure. The combined scrutiny of these
two acts is due to IN 70 (SARS, 2013b) stating that for a particular CSR expense, both the making of taxable supplies as set out in the VAT Act (89 of 1991) and the earning of taxable income in the Income Tax Act (58 of 1962) should be taken into consideration (SARS, 2013b). Furthermore, relevant case law (local and international) will be used to address the problem statement and objectives. The case law will be selected and analysed to assist in determining the input tax treatment of overhead expenditure, specifically CSR expenditure, in practice. International case law will be selected upon the relevance of the overhead expenditure that the ruling dealt with, as well as the applicability to the problem statement. European VAT legislation, specifically European Court Judgements ("ECJ") passed, will be utilised in this study, these judgements being deemed appropriate due to the similarity between the VAT Act (89 of 1991) and the EU’s Sixth Directive (77/388/EEC of 1977) principles relating to input tax. Various publications by authorities in the field of tax, such as auditing firms, law firms, SARS and banks, will be incorporated to appropriately address the problem statement.

1.5 DELINEATIONS AND INHERENT RESEARCH LIMITATIONS OF THE STUDY

1.5.1 Delineations

Other categories of taxation consequences such as capital gains tax ("CGT") and donations tax that may be applicable to CSR expenditure have not been taken into consideration as part of this study.

1.5.2 Inherent limitations

The current study does not aim to provide an exhaustive list of all possible CSR expenditures and the exact treatment thereof. The aim is rather to provide a general analysis of the factors that influence the VAT treatment of CSR expenditure in general.

1.6 CHAPTER OUTLINE

The lay-out of the research is as follows:
Chapter 1 introduces the background to the research, provides the problem statement, research objectives, research design and methodology, as well as the delineations and inherent research limitations of the study.

Chapter 2 explores the nature of overhead expenditure, specifically CSR expenditure. An overview of the background of CSR is furnished as well as the legal framework of CSR in South Africa and the possibilities for financial returns. Furthermore, some examples of the various ways that companies engage in CSR expenditure in practice will also be explored.

Chapter 3 considers the treatment of the input tax deductibility of overhead expenditure, specifically CSR expenditure. The South African VAT Act (89 of 1991) and Income Tax Act (58 of 1962) are inspected to shed light on the problem of the said tax deductibility. Furthermore, the judicial interpretation of the South African courts is used to interpret the VAT and income tax legislation.

In Chapter 4, a critical analysis of the South African and international case law, specifically European Judgements, will be performed in respect of the deductibility of input tax and the application thereof on CSR expenditure.

Chapter 5 contains a summation of the achievement of the research objectives, recommendations on issues identified in conducting this research, as well as suggestions for future research. Finally a conclusion with respect to the problem statement will be offered.
CHAPTER 2

THE NATURE OF CORPORATE SOCIAL RESPONSIBILITY EXPENDITURE

2.1 INTRODUCTION

Dame Anita Roddick once stated that being good is good for business as quoted by Williams (2007:10). Many South African companies are in the process of uplifting South African society. This is frequently carried out by incurring CSR expenditure (Ernst & Young, 2011). In a monthly newsletter, the law firm LCW states that in the present competitive business environment, CSR as a business approach and corporate strategy has been added onto the corporate agenda of businesses both big and small. Consumers in developed and developing countries alike can nowadays afford to be particular in their choice of business. The trend is that consumers choose to do business with companies whose CSR initiatives are aligned with their own view. Taking this into consideration, CSR is able to provide the differentiating edge in the highly competitive market that currently exists (LCW, 2013). To determine the tax treatment of this type of expenditure, the nature of the expense firstly needs to be determined.

It should, therefore, be considered whether CSR expenditure will form part of the general overhead cost incurred by a company and whether it will be treated in the same way for taxation purposes. This chapter will address research objective (i) stated in paragraph 1.3, by exploring and understanding the nature of overhead expenditure, specifically CSR expenditure.

2.2 OVERHEAD EXPENDITURE

The business cycle has many aspects to it. One aspect of business is, however, certain; costs will be incurred in the running of the business. The term “cost” may be explained as the measure of resources given up to achieve a specific objective (Drury, 2011:27). Costs can be divided into two categories: direct and indirect. Horngren,
Datar, Foster, Rajan and Ittner (2009:54) explain that direct costs are costs that can be directly traced to their economic feasibility, while, indirect costs cannot be directly traced to this. Indirect costs are costs incurred by many activities and cannot be assigned to certain services or products. These costs are required to operate the business as a whole. Examples are accounting and legal fees, administrative salaries, office, rent and telephone expenses and utilities (Anon., 2010). Other significant overhead costs incurred by companies, are those intended to raise capital. These are related to starting or expanding a business and include costs such as share transfer secretarial charges, listing fees, legal fees and fees payable for specialist consultants as well as merchant bankers (Van der Zwan & Stiglingh, 2011:319). Further examples of expenditure that is not closely linked to the business carried out by a company are, for example, stock exchange, B-BBEE and CSI costs (Smuts, 2012). From the definition and examples provided above, it can be understood that CSI or CSR expenditure can be regarded as overhead expenditure, since it is not directly traceable to the economic feasibility of a specific service or product, but rather to the business as a whole. Flowing from this, the meaning of CSR, the legal framework of CSR in South Africa, as well as the financial returns of CSR in a business and some examples of CSR in practice, will be further explored.

2.3 CSR

2.3.1 Introduction to CSR

Despite many efforts, there is still confusion in both the academic, as well as in the corporate world as to how CSR should be defined (Dahlsrud, 2006). Van Den Ende (2004:13) indicated that there is no single commonly accepted definition. A study on the various definitions was undertaken by Dahlsrud (2006) and it was shown that the challenge faced by companies is not to define CSR, but to rather understand how CSR is constructed socially in a specific context and how to apply this to the development of business strategies. According to Williams (2007:4), the United Kingdom (“UK”) Government describes CSR as referring to how a business takes account of its economic, social and environmental impacts in the way it operates. The following explanations for these specific impacts can be given. An economic impact may be anything that enhances a company’s own financial success. Social impact may include
a company’s impacts on its employees, suppliers, customers and others influenced by its operation. Furthermore, the environmental impact of the company is the complete effect it has on the environment and the world.

King III (2009) has set down the principle that a company should be a responsible citizen of the country and not only a profit making institution. A responsible citizen should be involved in social, environmental and economic issues and this is the triple context in which a company should operate (King, 2009a:11). To be a good corporate citizen, the company should, among other things, be socially responsible (King, 2009b:79). Corporate citizenship concerns integrating corporate responsibility into core business strategies, while at the same time adding value to shareholders and stakeholders (Van Den Ende, 2004:74). The terms of the glossary contained in King III (2009) (King, 2009b:117) define corporate citizenship as:

“an ethical relationship of responsibility between the company and the society in which it operates. As responsible corporate citizens of the societies in which they do business, companies have, apart from rights, also legal and moral obligations in respect of their economic, social and natural environments. As a responsible corporate citizen, the company should protect, enhance and invest in the wellbeing of the economy, society and the natural environment”.

Corporate responsibility is an important component of the broader notion of corporate citizenship. King III (2009) (King, 2009b:118), defines CSR or similarly CR, since these terms are indistinguishable in King III (2009), as:

“the responsibility of the company for the impacts of its decisions and activities on society and the environment, through transparent and ethical behaviour that: contributes to sustainable development, including health and the welfare of society; takes into account the legitimate interests and expectations of stakeholders; is in compliance with applicable law and consistent with international norms of behaviour; and is integrated throughout the company and practiced in its relationships”.

CSI refers to a business’s contributions to the community and society that are not relating to the regular business activities. These contributions may take the form of cash, resources or time spent. CSI is a key sub-set of corporate citizenship or CSR;
however it should not be construed as being synonymous with these terms (Van Den Ende, 2004:61). It is further important to note that CSI is only one manifestation of corporate responsibility. Even though it is a vital aspect of such responsibility, it should only be one integral component of the sustainability strategy (King, 2009b:118). The B-BBEE Empowerment Bill and JSE Social Responsibility Investment (“SRI”) Index render CSI part of the wider transformation authority. Businesses should count on CSI activities to enhance their reputation, engage communities, uplift employee morale, and to exhibit goodwill to government. CSI is good for business due to it having the potential to provide a platform for economic growth (Van Den Ende, 2004:69-71). Companies sometimes, in the CSR framework, draw attention to their donations, in the form of cash loans or assets. This philanthropy, however, falls outside the definition of CSR due to it directly relating to the distribution of profits, rather than the way in which the profits were earned (Williams, 2009:7).

The creation of the Sullivan Principles was seen as a turning point for CSR in South Africa (Van De Ende, 2004:84). Multinational organisations that did not disinvest from South Africa during the 1970’s were obliged to adhere to the Sullivan Principles. The aim of these principles was to require United States of America (“USA”) companies with South African investments, to treat their African employees in the same way as any American employee. These principles were re-launched in 1999 as the Global Sullivan Principles for Corporate Social Responsibility (“Sullivan Code”) (Van Den Ende, 2004:35-36).

The noteworthiness of the Sullivan Code, for the purposes of this study, lies in the precedent created by the appeal allowed in the Warner Lambert SA (Pty) Ltd v CSARS (2003) court case. In the Warner Lambert SA (Pty) Ltd v CSARS (2003) case, the Sullivan Code was explained as principles that made room for the non-segregation of various races in the work environment. It was set up to ensure fair and equal employment for all workers; programmes for development of training; growing the number of previously disadvantaged persons in management and supervisory positions as well as improving the quality of workers’ lives away from the work environment. The origin of this was that in 1986, the Comprehensive Anti-Apartheid Act was legislated by the United States Congress: a measure that had as its main aim
to add the statutory obligation for companies to comply with the Sullivan Code. These American companies, at the time were also required to ensure that their subsidiaries, specifically South African ones, complied with the said Act or the Sullivan Code. This court case is of key importance when considering CSR in the South African environment due to this being the first South African case that dealt with the deductibility of social responsibility expenditure for income taxation purposes. The Warner Lambert SA (Pty) Ltd v CSARS (2003) court case will be further examined in Chapter 3.

2.3.2 Legal framework for CSR in South Africa

King III (2009), states that the governance of companies can take either a statutory form or a code of principles and practices. It also advances a strong argument against the “comply or else” regime. King III (2009) says that the “comply or else” approach is not logically suitable due to the businesses of companies greatly varying from one another. The cost of a “comply or else” regime can also be seen as a major financial burden. Thus, in South Africa specifically, there is an example of statutory form, the Companies Act (71 of 2008), while an example of a code of principles and practices may be found in King III (2009). This country has opted for a “comply or explain” regime (King, 2009a:5). Although King III (2009) does not constitute an official legal document, its guidelines are considered as state-of-the-art regarding good corporate governance. The adoption of them is strongly recommended in the current business environment. The first King report, King I, was published in 1994; King II followed in 2002. The third version, King III (2009), has been effective from 1 March 2010. The JSE requires that listed companies disclose in their annual financial statements whether they have complied with King III (2009) or explain why they did not (Flores-Araoz, 2011).

The philosophy of King III (2009) is centred on leadership, sustainability and corporate citizenship. Responsible leadership directs the company to achieve economic, social and environmental sustainable performance. Sustainability is imperative. Nature, society and business are linked and this should be distinctly understood. A fundamental shift in the way a business is run should be undergone. The concept of “corporate citizenship” flows from the fact that a company should operate in a sustainable manner because the company is regarded as a person (King,
2009a:9-10). The whole of the first chapter of King III (2009) deals with ethical leadership and being a corporate citizen. In Chapter 9 of King III (2009) the financial disclosure of sustainability reporting, in the form of an integrated report, is explained. The integrated report should explain how the company has made its money, as well as the positive and negative effects that its operations have had (King, 2009b:74). However, due to King III (2009) not being passed into law, it should not be used as a checklist for compliance and non-compliance (Van Den Ende, 2004:90).

Indirect regulatory actions, for example King III (2009), can assist in promoting CSR in various industries. This is also assisted by the launch of the Johannesburg Stock Exchange Social Responsibility Index (“JSE SRI”) (Flores-Araoz, 2011). On 19 May 2004, the JSE made public this Index for listed companies; it started trading live on 20 May 2004. Organisations need to meet certain key rules set up by the JSE SRI before being included on the list. These key rules include a commitment to the main pillars of positive stakeholder relationships, environmental sustainability and to upholding and supporting human rights at a universal level. The intention of the JSE in launching this index was to encourage the application of best practices and to be answerable on a socially responsible level. It provides a method to measure the CSR of listed companies (Van Den Ende, 2004:92-93). The JSE SRI encourages investors to back friendly companies and pushes entities to build their environmental, social and governance initiative. This kind of responsible investment is a fairly innovative concept, as may be seen from the Dow Jones Sustainability Index, launched only in 1999 and the FTSE Good Index series, launched in 2001 (Flores-Araoz, 2011). The JSE SRI was the first index of its kind in the emerging markets (Van Den Ende, 2004:92).

2.3.3 B-BEE

According to Flores-Araoz (2011), not all CSR efforts in South Africa result from voluntary or indirect business decisions: some of them are due to the corporate compliance with BEE legislation. The B-BBEE Act (53 of 2003) and JSE SRI reinforces the importance of CSI as a pillar of CSR and renders CSI part of the larger transformation imperative (Van Den Ende, 2004:62,70). Thus, it is evident that CSR expenditure can be incurred for the specific purpose of maintaining and improving the B-BBEE scorecard (Ernst & Young, 2011).
The B-BBEE Act (53 of 2003) was incorporated in 2003. In terms of Section 9 of the B-BBEE Act (53 of 2003), the Minister may issue Codes of Good Practice by notice in the Gazette. The Code of Good Practice contains the B-BBEE generic scorecard. The scorecard comprises seven categories, each of which, if complied with, can earn the business a certain number of points. Based on the overall performance, the entity will receive a B-BBEE status ranging from level eight to level one (Department of Trade and Industry, 2007:11). The seven categories of the scorecard can be split into either direct or indirect Empowerment Measures. Direct Empowerment Measures consist of Ownership, Management and Employment Equity, whereas indirect Empowerment Measures are made up of Preferential Procurement, Enterprise Developments, Skills Development and Socio-Economic Development (Acker, 2012:1). Thus, it may be seen that businesses will incur expenditure for direct or indirect Empowerment Measures to enhance their B-BBEE rating. The reasons behind complying with B-BBEE are numerous; some being that this is a legal requirement thus, preferential procurement can be obtained and the market or public image of a company can be enhanced. The reasons examined could all have a positive or negative profitable effect on a company. The legal requirement is retained in Section 10 of the B-BBEE Act (53 of 2003) which requires any organ of state and any public entity to comply with B-BBEE. This affects profitability, owing to the cost of the obligation to comply in terms of the law. One benefit of a good scorecard is that it may result in Preferential Procurement, which can lead to a positive impact on the business in the long term. Marketing may also be a driving force for a business to attain a good B-BBEE rating. A B-BBEE rating can also help a business avoid losing customers to B-BBEE compliant competitors. Hence, all of these points just discussed indicate that business will want to attain a good B-BBEE rating, not just for the cause, but because it serves a financial purpose as well (Acker, 2012:23-25).

The government is required to take positive steps to promote socio-economic rights. One way in which this has been done is through the element of Socio-Economic Development in the B-BBEE scorecard (Bowman Gilfillan, 2005:47). Thus, the Socio-Economic Development Contributions that a business pays may be regarded as an example of CSR expenditure. Socio-Economic Development Contributions could consist of monetary or non-monetary contributions. These should actually be initiated and implemented by the Measured Entity in favour of the beneficiaries. The specific
objective should be to facilitate sustainable access to the economy for those beneficiaries. Code Series 700 of the Codes of Good Practice also provides a non-exhaustive list of Socio-Economic Development Contributions. These include, for example, grant contributions, as well as direct and overhead costs that are directly attributable to Socio-Economic Development Contributions (Department of Trade and Industry, 2007:72).

There are certain additional charters applicable to certain sectors in South Africa that will affect the B-BBEE score of a company (Acker, 2012:16). For example, The Broad Based Socio Economic Empowerment Charter for South African Industry, referred to as the Mining Charter, released in 2002 and amended in September 2010. Its aim is to advance the social and economic welfare of mining communities. This is effected by requiring certain types of expenditure for community development, housing and living conditions (Department of Trade and Industry, 2010:2-4).

For taxation purposes, companies should clearly document that, when applicable, the aim of CSR expenditure is incurred for B-BBEE purposes. Furthermore, when expenditure, for example training, education and environmental conservation, is undertaken, the company should ensure that this expenditure is in terms of the specific B-BBEE sector charter applicable to the company. It should be kept in mind that companies are in effect entities with the aim of maximising profits and the incurment of CSR expenditure or B-BBEE costs may result in a business benefit (Ernst & Young, 2011). Thus, the financial returns of CSR expenditure should be considered, in order to fully understand the possible benefit that might be obtainable by a company.

2.3.4 Financial returns of CSR expenditure

Barnett (2007:796) has raised the question as to whether CSR builds or destroys corporate wealth. Critics of CSR oppose expending limited resources on social issues. The reason they advance is that CSR expenditure increases the cost of a company and decreases its competitive position (Barnett, 2007:795). Another objection is that, in their opinion, CSR interferes with the efficient resource distributions of a business’s commercial activity. It is this that produces profit, and through profit a company contributes to society and its welfare anyway (Williams, 2007:9). The other side of
the argument is that CSR increases trustworthiness and enhances the firm’s relationship with important stakeholders. This, in turn, decreases the costs of transactions and ends in financial gain (Barnett, 2007:796). There are various commercial factors that may inspire a company to be more socially responsible. The general and most significant factor, however, is the reputational effect of social responsibility.

Boards and shareholders are demanding that the outcome from investments in CSR be measured to understand how it has impacted on the profitability of firms. Thus, the investment in CSR is under careful scrutiny. The leaders of a business, embarking on CSR, should be mindful of the value added by the CSR activity. Research shows that CSR can lead to positive outcomes, such as a willingness to pay premiums, a lowered reputational risk during a crisis period and increased loyalty displayed by customers. Every one of these outcomes may provide the opportunity for profit growth (Noked, 2011). It should be kept in mind that not all CSR expenditure maximises profits; however, some may. Consequently, the careful consideration of CSR may well meet the fiduciary responsibilities of managements. Businesses should, therefore, treat any CSR decision in the same light as any investment decision made by them (Barnett, 2007:813).

2.4 CSR EXPENDITURE IN PRACTICE

Companies in practice engage in social responsibility in various ways. For example, the largest brewing company in South Africa, SAB Miller and its South African subsidiary SAM Limited, has set ten sustainable development priorities as part of its global policy towards social responsibility. These priorities include, for example, HIV/AIDS, communities, human rights and waste. SAB Miller also periodically monitors its affiliates to determine whether they comply (Flores-Araoz, 2011).

Another South African example is MTN, the multinational telecommunications company, which provides funds to its social investment vehicle, MTN South Africa (“SA”) Foundation, of up to 1% of profit after tax (MTN, 2013). A project of the MTN SA Foundation for Mandela Day 2013 was the handover of prefabricated classrooms to a school. This included the donation of other equipment as well, such as fridges, desks and chairs (MTN SA Foundation, 2013). International companies also
undertake various CSR efforts. Starbucks created C.A.F.E. Practices Guidelines, designed to ensure the company only sources sustainably grown and processed coffee. Tom’s Shoes, a company in the USA, donates one pair of shoes for every pair purchased to a child in need (Brooks, 2013). Thus, in practice, the CSR expenditure incurred varies vastly between companies.

2.5 CONCLUSION

Companies in South Africa are becoming more involved in solving the economic, social and environmental problems faced by the country. Each of these businesses is affected by the growing demands regarding CSR. The view that CSR and profitability are mutually exclusive has changed, and the aim of a business has similarly been altered: not only to generate profits, but also to be socially responsible. Currently, South African businesses are already in the position where substantial expenditure is incurred by them, pertaining to their obligation to fulfil their social responsibilities (Deloitte, 2010). CSR may be perceived as a legitimate interest of business and a way to conduct business, rather than just an appendix to a business. Therefore companies should consider their approach to CSR in all aspects of business activity (Williams, 2009:38).

The actual meaning of CSR will differ from one business to another. Companies need to set CSR objectives, which will be able to enhance their individual businesses financially. After the implementation of these, the objectives need to be subsequently pursued. The income and VAT tax implications of these objectives should also be considered. This is necessary due to the fact that CSR expenditure might not be deductible for income and VAT purposes in all scenarios. At present, companies incur such expenditure and often treat these expenses as deductible for income tax purposes. This is done without considering the merits of this treatment. Companies are, therefore, advised to be aware of the various ways in which this expenditure can be treated for income tax purposes (Ernst & Young, 2011). Furthermore, the VAT treatment of CSR expenditure should also be considered by companies due to the possibility that SARS may consider the input tax non-deductible on certain of their gratuitous endeavours (Deloitte, 2010). SARS has made it clear in IN 70 (SARS, 2013b) that input tax on expenditure by a vendor in accordance with its CSR
objectives, is not always deductible, whether it is to comply with statutory
requirements or incurred as part of a voluntary programme: it depends on the facts
and circumstances of each case. The following chapter will, therefore, shed light on
the problem of the input tax deductibility of CSR expenditure. A detailed inspection
of factors that influence the input tax deductibility of overhead expenditure incurred,
specifically the CSR expenditure, will be performed as to determine when the input
tax will be deductible.
CHAPTER 3

THE INPUT TAX DEDUCTIBILITY OF CSR EXPENDITURE

3.1 INTRODUCTION

Benjamin Franklin once said "…in this world nothing can be said to be certain, except death and taxes." (Franklin, 1907:69). In the last decade of the twentieth century there is hardly a single economic act that is free from tax consequences. The portfolio of the tax system comprises direct and indirect taxes. Each of these has its own tax base (Emslie et al., 2001:1). Direct tax is borne by the entity and cannot be passed on to another entity, whereas in contrast, indirect tax, such as VAT or sales tax, may be defined as a tax where the burden of the liability is passed on to another entity or person (Riley, 2012). To further describe indirect tax, it can be explained as a tax levied on services and goods, rather than on profits or income (Oxford Dictionary, 2013). Both these type of taxes should be taken into consideration when a taxpayer undertakes any type of transaction. This chapter explores the deductibility of input tax on overhead expenditure, specifically CSR expenditure (refer to objective (ii) in paragraph 1.3). Furthermore, the chapter critically analyses the VAT legislation regarding the treatment of overhead expenditure in general and CSR expenditure specifically (refer to objective (iii) in paragraph 1.3). The South African VAT Act (89 of 1991) and Income Tax Act (58 of 1962) are inspected to shed light on the problem of the input tax deductibility of overhead expenditure, specifically CSR expenditure. Furthermore, the judicial interpretation of the South African courts is utilised to interpret the VAT and income tax legislation.

3.2 BACKGROUND TO VAT IN SOUTH AFRICA

VAT is a tax instrument used by many countries around the world. The VAT system varied from one country in the European Union (“EU”) to another, until the Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – the Common System of Value Added Tax: Uniform Basis of Assessment on VAT (“Sixth Directive”) was introduced and
established consistent rules in the EU for VAT. VAT can be explained as a form of indirect tax, levied on the added value of the different stages of production (Kearney, 2003:21). It has been introduced by many developing countries and is experienced as an effective tax by most countries (Kearney, 2003:23). In the most recent count, the VAT system is in operation in numerous countries worldwide (Clegg & Wiid, 2012:1). The European VAT system was consulted when the South African VAT legislation was developed (Van der Zwan & Stiglingh, 2011:323).

The VAT Act (89 of 1991) was introduced in 1991 to replace the Goods and Services Tax (GST). VAT is levied in South Africa on the supply and importation of goods and services, in terms of Section 7 of the VAT Act (89 of 1991), whereas the exporting of goods and services will not have VAT implications, in terms of the zero-rating provisions of Section 11(1)(a) and Section 11(2)(a). VAT was first charged at 10%, but was increased on 7 April 1993 to the current rate of 14% levied in terms of Section 7(1) of the VAT Act (89 of 1991) (Kearney, 2003:21; Taxation Laws Amendment Act 136 of 1992).

The legislative design of the South African VAT system is affected by international principles and characteristics; therefore to fully understand the system, the international principles and characteristics should also be understood (SARS, 2013b). Further information regarding this will be provided in Chapter 4 where an analysis will be performed comparing the differences and similarities of the South African VAT system and international principles and characteristics. The mechanics of the South African VAT system will now be further explained, as it is of the utmost importance for businesses to understand VAT, because this has a direct impact on their cash flows (Stiglingh, et al., 2013:1066).

3.3 THE MECHANICS OF VAT

VAT is essentially a tax collected by vendors on behalf of SARS on the value added by them by carrying out their business. The vendor will pay over the amount of VAT charged on a good or service to SARS and the end user will pay the amount inclusive of VAT to the vendor for the goods or services. While VAT is theoretically a tax on the value added, a business does not have to physically calculate the value added; rather it accounts for the difference between the input and output tax (Deloitte, 2013).
When a company is a vendor in terms of the VAT Act (89 of 1991) and makes taxable supplies, the vendor is obliged to charge VAT on all business transactions that constitute taxable supplies (Stiglingh, et al., 2013:1073). Section 7(1)(a) of the VAT Act (89 of 1991) provides guidance on the imposition of output tax:

“7. Imposition of value-added tax.—(1) Subject to the exemptions, exceptions, deductions and adjustments provided for in this Act, there shall be levied and paid for the benefit of the National Revenue Fund a tax, to be known as the value-added tax—

(a) on the supply by any vendor of goods or services supplied by him on or after the commencement date in the course or furtherance of any enterprise carried on by him;”

Section 7(1)(b) of the VAT Act (89 of 1991) imposes VAT on the importation of any goods into South Africa by any person. Section 7(1)(c) specifically refers to the supply of imported services, the definition of which is provided in Section 1 of the VAT Act (89 of 1991) as a supply of services to a resident of South Africa, by a supplier situated outside South Africa, to the extent that such services are not utilised or consumed for the purpose of making taxable supplies. Thus, if a service obtained from an international source, meets the definition provided, a 14% output tax will be charged on this service.

To fully comprehend the imposition of VAT, the various underlying criteria in Section 7(1)(a) need to be understood. The criteria may be broken down as follows:

- The supply
- of goods or services
- by a vendor
- in the course or furtherance of any enterprise.

3.3.1 Supply

The term “supply” is defined in Section 1 of the VAT Act (89 of 1991) as “….performance in terms of a sale, rental agreement, instalment credit agreement and all other forms of supply, whether voluntary, compulsory or by operation of law,
irrespective of where the supply is effected, and any derivative of ‘supply’ shall be construed accordingly”. This can be further broadened by examining the definition per the *Oxford Dictionary* (2013) where it is explained as the making available of something, or to provide it. The breadth of the definition can be demonstrated in the National Educare v CSARS (2001) case, where the court held that the word “supply” has various meanings that are very wide. It also held that Section 7(1)(a) makes it clear that there are two requirements before VAT can be levied: that a supply must be present and such supply must be made in the course or furtherance of any enterprise carried on by the vendor.

In the National Educare v CSARS (2001) case, the applicant was an educational and charitable organisation. The applicant claimed input tax, but did not reflect output tax payable on supplies made. The Commissioner for SARS requested the output tax to be accounted for by the applicant on the payments received from the Government for providing food to the schools. The applicant contended this and stated that it only procured the supply of the food, on behalf of the Government. Various subcontractors were used to deliver the food. It was held that even though the vendor did not directly supply the food, but used subcontractors, the vendor was liable for output VAT on the remuneration amount.

### 3.3.2 Goods and services

Goods and services are defined in Section 1 of the VAT Act (89 of 1991). The term “goods” is defined as physical movable things, electricity, fixed structures, land, buildings as well as the right to any such things. Money, mortgage bonds or pledges are specifically excluded from the definition of goods. “Services” means “anything done or to be done including the granting, assignment, cession or surrender of any right or the making available of any facility or advantage”. The word “services” embraces anything that does not qualify as goods for practical purposes (Clegg & Wiid, 2012:11).

### 3.3.3 Vendor

Output tax is only applicable when a supply is made by a vendor. A “vendor” in terms of the Section 1 of the VAT Act (89 of 1991), is defined as any person required to be
registered or already registered under the VAT Act (89 of 1991). The definition for a
person in Section 1 of the VAT Act (89 of 1991) includes public authorities,
municipalities, companies, bodies of persons (corporated or unincorporated), deceased
or insolvent estates, trust funds and foreign donor funded projects. A person may
register on their own accord when the minimum requirement, that the value of taxable
supplies is expected to exceed R50 000 in a period of 12 months, is met (Section
23(3) of the VAT Act (89 of 1991). A person is liable to register when the criteria set
out in Section 23 of the VAT Act (89 of 1991) are met. Section 23(1) states that
where the value of taxable supplies exceeds or is expected to exceed R1 million in a
period of 12 months, the person will become liable to register, and that the value in
respect of a supply refers to the consideration defined in Section 1 of the VAT Act (89
of 1991) received, reduced by the amount of 14% that represents VAT (Section 10(2)
of the VAT Act (89 of 1991). The onus lies with the taxpayer to register for VAT
purposes. The person must apply for registration within 21 days. If a person who is
obliged to register fails to comply, SARS may register the taxpayer for the type of tax
appropriate under the circumstances (Section 22 of the Tax Administration Act (“TA
Act”), 28 of 2011).

3.3.4  In the course or furtherance of any enterprise

Only where a vendor supplies goods and services in the course or furtherance of an
enterprise carried on or partly in South Africa, will VAT be applicable (Section 7(1)
of the VAT Act 89 of 1991). Thus, if goods are supplied by a vendor, but this was not
entered into in the course or furtherance of an enterprise, this will not attract any
VAT. The term “enterprise” will be inspected in more detail because each transaction
carried out by a vendor will have to be assessed regarding whether it was done in the
course or furtherance of an enterprise.

3.3.4.1  Definition of “enterprise”

Section 1 of the VAT Act (89 of 1991) states that an “enterprise” means:

“(a) in the case of any vendor, any enterprise or activity which is carried on
continuously or regularly by any person in the Republic or partly in the
Republic and in the course or furtherance of which goods or services are
supplied to any other person for a consideration, whether or not for profit,
including any enterprise or activity carried on in the form of a commercial, financial, industrial, mining, farming, fishing, municipal or professional concern or any other concern of a continuing nature or in the form of an association or club”.

The definition of an enterprise is not limited to paragraph (a) of the definition in Section 1 of the VAT Act (89 of 1991). Paragraph (b) of this section contains specific inclusions for an enterprise, being the making of supplies by any public authority, as well as the activities of a welfare organisation, share block company and a foreign donor funded project. Furthermore, paragraph (c) of this definition provides information for a vendor that is a local authority. The definition also contains provisions as to when a person shall be deemed not to be carrying on an enterprise, for example the rendering of services by an employee in the course of his employment.

The term “enterprise” specifically requires supplies to be made for a “consideration”. For purposes of clarification, a supply for a consideration is now further inspected, as this provision will have a direct impact on whether any expense was indeed undergone in the course or furtherance of an enterprise.

3.3.4.2 Supply for a consideration

The term “consideration” fundamentally means the total amount of money received for a supply (SARS, 2013a). The VAT Act (89 of 1991) defines consideration in Section 1 as a payment made or to be made with regard to the supply of goods or services to any person. This payment can be made in money or otherwise and includes any act or forbearance, voluntary or not. This definition specifically excludes a donation to any association not for gain.

The need for a supply made for a consideration is the one aspect of VAT that is occasionally overlooked. A general requirement of an enterprise is that a consideration must be charged. The form of consideration may be non-monetary or monetary. This general requirement has significant implications; the making of supplies for no consideration will not be regarded as taxable supplies, and thus, to the extent of expenditure being incurred for non-taxable purposes, no input tax may be deducted (SARS, 2013b). To deliberate this significant implication further, the concept of input tax in terms of the VAT legislation needs to be considered.
THE CONCEPT OF INPUT TAX

Section 16 of the VAT Act (89 of 1991) contains the legislation regarding the calculation of VAT payable or receivable. In terms of Section 16(3) of the said Act the amount of VAT payable in respect of a tax period shall be calculated by deducting from the sum of the amount of output tax, the amount of input tax. This is subject to the provision included in Section 17 of the Act, which provides for permissible deductions in respect of input tax and states that the latter tax is deductible only to the extent that goods or services are acquired in the course of making taxable supplies. This section indicates that the definition in Section 1 of input tax in the given Act should be met for this to occur. The necessary documentation should be held by the vendor before this deduction is probable (Section 16(2) of this Act (89 of 1991).

The definition of input tax in Section 1 and as referred to in Section 17 of the given Act should firstly be considered. Input tax is defined as follows in Section 1 of the said Act (89 of 1991):

"input tax", in relation to a vendor, means—

(a) tax charged under section 7 and payable in terms of that section by—

(i) a supplier on the supply of goods or services made by that supplier to the vendor…;

Where the goods or services concerned are acquired by the vendor wholly for the purpose of consumption, use or supply in the course of making taxable supplies or, where the goods or services are acquired by the vendor partly for such purpose, to the extent (as determined in accordance with the provision of section 17) that the goods or services concerned are acquired by the vendor for such purpose;”.

In the scenario where the input tax exceeds the output tax, the amount will be refundable to the vendor by the Commissioner (Section 16(5) of the VAT Act, 89 of 1991). The input tax is only claimable, provided that the taxpayer was or should have been registered for VAT, as there is a specific reference to “vendor” in the definition of input tax above. The further key areas of deductibility of input tax, as per the
definition of input tax, can be set out as follows: output tax liability may only be
reduced by the input tax to the extent that the VAT is incurred for the purpose of use,
consumption or supply in the course of carrying on an enterprise, thus in the making
of taxable supplies (Section 17 of the VAT Act, 89 of 1991). “Taxable supplies” are
defined in Section 1 of the VAT Act (89 of 1991) as any supply of goods or services
chargeable under the provisions of Section 7(1)(a) with tax, which includes zero-
rated supplies in terms of Section 11.

Input tax may be limited or disallowed where goods or services are acquired by the
vendor for private purposes, exempt supplies and other non-taxable purposes (SARS,
2013a). No credit of input tax is available when exempt supplies, as determined in
Section 12 of the VAT Act (89 of 1991), are made, due to this being specifically
excluded from the definition of an enterprise. Section 17(2) of the VAT Act (89 of
1991) prohibits the deduction of input tax, in the case of certain types of transactions
undertaken, for example expenditure for the purpose of entertainment or in respect of
any motor car supplied to or imported by the vendor. Furthermore if the expenses are
for both taxable and non-taxable purposes, an apportionment of input tax must be
made (Section 17(1) of the VAT Act (89 of 1991)).

The percentage of the apportioned amount of input tax deductible is affected by
whether the specific inputs are limited or disallowed, as well as the extent of
utilisation of the supply for taxable supplies (SARS, 2013a). The extent of utilisation
of the supply for taxable supplies refers to the apportionment between taxable and
non-taxable supplies (Section 17(1) of the VAT Act, 89 of 1991). Where the intended
use of goods and services in the course of making taxable supplies is 95% and more,
this use may be regarded as having been made exclusively for the purpose of taxable
supplies (Section 17(1)(a) of the VAT Act, 89 of 1991).

3.5 INPUT TAX DEDUCTIBILITY OF CSR EXPENDITURE

As indicated in paragraph 2.5, CSR is of growing importance for companies; they are
consequently investing more time and money into CSR. Vendors undertake various
forms of CSR expenditure to meet their CSR objectives. However, in carrying out all
these activities, the vendor may not always charge a consideration for the supply
made (SARS, 2013b). When no consideration is charged, the entity faces the risk that
the term “enterprise” is not met, which will result in the input tax not being deductible.

An earlier BPR 53 (SARS, 2003) ruling dealt with the VAT implications arising from a building which was constructed, then donated after completion. The applicant for this ruling was a registered VAT vendor. The applicant made a commitment whereby it undertook to construct a building and thereafter donate the building to the VAT exempt recipient. In terms of this commitment the applicant paid contractors, and donated certain building material required for the construction of the building. SARS ruled that the applicant was not required to levy and account for VAT on the donation made, as the supply of the buildings was made for no consideration and the value of the supply was deemed nil in terms of Section 10(23) of the VAT Act (89 of 1991). The ruling further determined that the applicant could claim the input tax on the construction costs in terms of Section 16(3)(a), read with the definition of input tax in Section 1 of the VAT Act (89 of 1991). This ruling reconfirms the established approach of SARS to the claiming of input tax, where goods or services are distributed free of charge under taxable supplies (PwC, 2010). It should be taken into account that this was only a BPR. Advanced rulings are defined as a binding private, general or class ruling in Section 75 of the Tax Administration Act (“TA Act”) (28 of 2011). The purpose of advanced rulings per Section 76 is to encourage clarity, consistency and certainty concerning the interpretation and application of a tax Act. The rulings are published as general information, and may not be quoted in proceedings before the Commissioner. These published rulings are only used to show how SARS may interpret certain legislation (Cliffe Dekker Hofmeyr, 2010).

SARS published IN 70 (SARS, 2013b) on 14 March 2013, subsequent to this ruling. The purpose of this interpretation note is to provide guidance to vendors on the deductibility of input tax on goods or services acquired to make supplies for no consideration. IN 70 (SARS, 2013b) also sets out the legal framework regarding the VAT treatment of supplies and goods or services made for no consideration. Guidance around the input tax treatment of CSR expenditure is included in this interpretation note. The general rule provided in IN 70 (SARS, 2013b) is that a supply made for no consideration, made in the course or furtherance of an enterprise by a vendor, will generally be regarded as a taxable supply. If the term “taxable supply” is met, the
input tax will be deductible. IN 70 (SARS, 2013b) sets out that there is no single test that can be applied on the treatment of CSR expenditure except for this general rule. The burden of proving that the CSR expenditure was expended in the course or furtherance of an enterprise lies with the taxpayer (Section 102 of the TA Act, 28 of 2011). Without the necessary proof required, the input tax deduction will not be available. Various resources are available to a taxpayer, for example legislation and precedents set in court cases. There is, however, no specific section in the VAT Act (89 of 1991) or Income Tax Act (58 of 1962) that deals with the deductibility of CSR expenditure for VAT or income tax purposes.

The Warner Lambert SA (Pty) Ltd v CSARS (2003) case is the authoritative South African case referred to in this respect. The dispute in this case was as to whether the amount of social responsibility expenditure claimed as a deduction by the appellant was indeed allowable. The Commissioner first allowed these amounts for deduction, but then in a revised assessment, disallowed the expenditure on the basis that it had not been incurred in the production of income. The appellant appealed to the Cape Special Income Tax Court.

The background to this case was that the appellant was instructed by its parent company in the USA to incur expenses in terms of the Sullivan Code obligations. The Sullivan Code was of such importance that the possibility of disagreeable consequences in the USA existed if the appellant failed to comply. Thus, it was made clear that if these expenses were not incurred, the appellant would have suffered a loss of income. The appellant therefore sought to deduct these social responsibility expenses in terms of Section 11(a) and Section 23(g) of the Income Tax Act (58 of 1962). Judge Conradie, AJ stated that deductible expenditure has certain characteristics; it must be incurred in the production of income and expended for the purpose of trade. Conradie, AJ also stated that moneys expended from motives of pure liberality fail to qualify as expenditure in the production of income. Judge Davis, J ruled in favour of the appellant in the Cape Special Income Tax Court and allowed the expenditure.

In general, the principles in the Warner Lambert SA (Pty) Ltd v CSARS (2003) case can be applied under the VAT Act (89 of 1991), in the sense that the expense being incurred for income tax purposes in the production of income will normally also be
incurred “….in the course or furtherance of an enterprise” for VAT purposes (SARS, 2013b). This is with the consideration that the specific deduction of the expense under contemplation is attributable to both the earning of taxable income under the Income Tax Act (58 of 1962) and the making of taxable supplies under the VAT Act (89 of 1991) (SARS, 2013b). To further understand the terms “….in the production of income” and “taxable income” noted above, the provisions of the Income Tax Act (58 of 1962) in respect thereof will be elaborated on, in the analysis of the general deduction formula below. The detail of the general deduction formula will then be applied on CSR expenditure to demonstrate when CSR will be deductible under the Income Tax Act (58 of 1962).

3.6 GENERAL DEDUCTION FORMULA

Section 5 of the Income Tax Act (58 of 1962) determines that income tax is payable on the amount of taxable income calculated. Taxable income as defined in Section 1 of the Income Tax Act (58 of 1962) means the aggregate of amounts to be included or deemed to be included in a person’s taxable income in terms of the Income Tax Act (58 of 1962) and the amount remaining from the income after the deduction of all amounts allowed in Part I of Chapter II of the Income Tax Act (58 of 1962).

These deductible amounts are generally allowed in terms of the general deduction formula consisting of Section 11(a), read together with Section 23(g). The general deduction formula in the Income Tax Act (58 of 1962) may be split into a positive and a negative requirement (Williams, 2007:418). The positive requirement entails Section 11(a) of this Act (58 of 1962) which reads as follows:

“For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived-

expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature;”.

The positive requirement provides detail regarding what may be deducted and should be read together with Section 23(g), the negative requirement, being the amount that
may not be deducted. Section 23 disallows certain deductions, and Section 23(g) reads as follows:

“(g) any moneys, claimed as a deduction from income derived from trade, to the extent to which such moneys were not laid out or expended for the purposes of trade;”.

Thus, both these sections need to be consulted to determine the deductibility of an amount. In summary, the Income Tax Act (58 of 1962) contains positive and negative sections, which will allow a deduction when the following criteria are met:

- expenditure and losses;
- actually incurred;
- in the production of income;
- not of a capital nature;
- carrying on a trade.

Each of the components of the general deduction formula, as listed above, will be considered. In many cases, the legislation alone does not provide clear rules and relevant case law will be examined for further clarity. The theoretical principles explained below will be applied in paragraph 3.7 on the deductibility of CSR expenditure in terms of the Income Tax Act (58 of 1962).

### 3.6.1 Expenditure and losses

The term “loss” has not been defined in judgements passed by the courts. In the Joffe & Co (Pty) Ltd v Commissioner for Inland Revenue (“CIR”) (1946) case, Judge Watermeyer CJ stated that the word loss has several meanings, and went on to say that when referring to trading operations the word may be used to signify a deprivation suffered. A loss was usually an involuntary deprivation and an expense a voluntary one. Expenditure is not only limited to payment made in cash, but also includes any other payment made with a monetary value. Expenditure thus basically requires a movement or decrease in assets for the person incurring the expense (Stiglingh et al., 2013:138).
3.6.2 Actually incurred

The Income Tax Act (58 of 1962) does not use the specific words “necessarily incurred”. In the Port Elizabeth Electric Tramway Company Ltd v CIR (1936) case, Judge Watermeyer AJP pointed this out, indicating that the words of the statute are “actually incurred” not “necessarily incurred”. Thus any expense is still actually incurred regardless of the intent of the expenditure. In the Caltex Oil (SA) Ltd v Secretary for Inland Revenue (“SIR”) (1975) case the judges came to the conclusion that expenditure actually incurred does not necessarily have to mean expenditure paid for in the year of assessment; only a liability for payment is required. In the Port Elizabeth Electric Tramway Company Ltd v CIR (1936) case Watermeyer AJP stated that “actually incurred” does not mean actually paid.

3.6.3 In the production of income

In the Port Elizabeth Electric Tramway Company Ltd v CIR (1936) case, two questions were established that should be taken into account when determining whether expenditure is in production of income: whether the act to which the expenditure is attached is performed in the production of income and whether the expenditure is linked closely enough to it. Judge Watermeyer AJP said that items of expenditure attached to the *bona fide* business operations undergone for the purpose of earning income are deductible, whether these items are necessary or are incurred for the more efficient performance of the business, provided that they are so closely connected that they may be regarded as part of the *bona fide* business operations. The CIR v Genn & Co (Pty) Ltd (1955) case added further emphasis to this connection. The court stated that the closeness of the connection between the expenditure and the income-earning operations has to be assessed to decide how the expenditure should be regarded. This should be carried out by having regard to both the purpose of the expenditure and the actual effect thereof. In the Sub-Nigel Ltd v CIR (1948) case the court was not concerned whether a specific item of expenditure produced any portion of the income; the main concern was whether that item of expenditure was incurred for an income earning purpose.
3.6.4 Not of a capital nature

In the British Insulated and Helsby Cables Ltd v Atherton (1926) case, a test was invented to determine when expenditure was capital in nature. The test is to enquire if the expenditure was incurred to bring an asset or an enduring benefit into existence. If this test is met, the expenditure can be regarded as capital in nature. In the New State Areas Ltd v CIR (1946) case it was determined that one has to examine whether the expenditure is for floating or fixed capital. If the cost only performs an income generating function, then it is not capital. Nonetheless once it adds to the income-earning structure it is considered as capital and is not deductible. The CIR v African Oxygen Ltd (1963) case explains that once the taxpayer acquires an asset or obtains an enduring benefit as a result of incurring the expenditure, then it will be seen as capital in nature.

3.6.5 Carrying on a trade

Section 11 of the Income Tax Act (58 of 1962) will only allow a deduction when a trade is carried on by the entity. In the Commissioner for Inland Revenue (“CIR”) v George Forest Timber Company Ltd (1924) case, Judge De Villiers JA said that anything received by a person, in the way of his trade business or profession, will be seen as income. For many years this set principle held true. It was, however, significantly refined in the CIR v Pick ‘n Pay Employee Share Purchase Trust (1992) case (Williams, 2009:245). In the said case, the distinction was drawn between the carrying on of a business and the pursuance of a profit-making scheme. Thus only if the income earned by a company constituted a profit-making scheme, would it be taxable income. The term trade is not important by itself in determining the taxable income. The fact that a company is trading has relevance for both the taxable income and the deductibility of an amount (Williams, 2009:246). The term “trade” for purposes of the general deduction is defined in Section 1 of the Income Tax Act (58 of 1962). The definition includes every profession, business, trade and venture. Due to the broad definition, relevant case law should be considered to determine whether the trade requirement will be applicable. In the Burgess v CIR (1993) case, it was held that the definition of trade should be given a wide interpretation. The term “venture” is further defined in the Income Tax Case No. (“ITC”) 368 (1936) case as “…a transaction in which a person risks something with the object of making a profit”.

Even though it is evident that the term “trade” has a wide meaning, it does not include all activities, for example dividends, interest and other forms of passive income (Stiglingh et al., 2013:135).

3.7 APPLICATION OF THE INCOME TAX ACT (58 OF 1962) ON CSR EXPENDITURE

From the general deduction formula provided above, one should note that the important consideration to keep in mind for the deduction of CSR expenditure is whether the expenditure has been incurred in the carrying on of a trade and the production of income. If the CSR expenditure constituted pure donations made for a philanthropic purpose, the expenditure would not qualify for the deduction in Section 11(a), read together with Section 23(g) in terms of the Income Tax Act (58 of 1962), as it is not made in carrying on of a taxpayer’s trade or in the production of income (CIR v Pick ’n Pay Wholesalers (Pty) Ltd (1987)).

It has been held in the case of Warner Lambert SA (Pty) Ltd v CSARS (2003) that costs incurred to comply with the Sullivan Code, which indirectly enabled the taxpayer to continue its trade in South Africa, were sufficiently closely linked to the taxpayer’s trade and the activities that produced his income for these costs to be viewed as being incurred in carrying on a trade and in the production of income. The other important factor always to consider when looking at expenditure is whether it may be capital in nature. When viewing a CSR expense, one should assess whether this expenditure is more closely related to acquiring or enhancing the income earning structure, than to the operating of the taxpayer’s income earning structure (New State Areas Ltd v CIR (1946)). Furthermore, one should assess whether the taxpayer acquires an asset or obtains an enduring benefit as a result of incurring the expenditure (CIR v African Oxygen Ltd (1963); British Insulated and Helsby Cables Ltd v Atherton (1926)).

The Warner Lambert SA (Pty) Ltd v CSARS (2003) case is not a remedy for the deductibility problems inherent to CSR expenditure (Clegg, 2009). Thus, the facts and circumstances around CSR expenditure should be closely scrutinised, as explained in the general deduction formula above, to determine whether this expenditure is
deductible and also whether it is capital in nature and thus carries the risk of not being deductible.

As indicated in paragraph 2.3.5, the financial returns resulting from CSR expenditure may have a positive business effect (Ernst & Young, 2011) and may provide the opportunity for profit growth in a company (Noked, 2011). This demonstrates that it may be argued that CSR expenditures are incurred in the production of income, for Income Tax Act (58 of 1962) purposes, and when this is in turn applied for VAT purposes, it can also be argued that this expenditure is “in the course or furtherance of an enterprise” in terms of the VAT Act (89 of 1991). The view that the Income Tax Act can be applied for VAT purposes is supported by SARS (2013b) stating that the principles in the Warner Lambert SA (Pty) Ltd v CSARS (2003) case, a case dealing with the Income Tax Act (58 of 1962), can normally be applied to determine “…in the course or furtherance of an enterprise” for VAT purposes (SARS, 2013b).

If this approach is followed, it will depend on the facts and circumstances of the situation. The situational differences can be shown by the following example: a cash donation to a Public Benefit Organisation (“PBO”) as defined in the Income Tax Act (58 of 1962) will be deductible in terms of Section 18A of the Income Tax Act (58 of 1962) if certain criteria are met. However, this does not constitute a supply of goods in terms of the VAT Act (89 of 1991) since money is specifically excluded from the definition for goods in Section 1 of the VAT Act (89 of 1991). Therefore, when applying the Income Tax Act (58 of 1962) for VAT purposes, SARS (2013b) places emphasis on the fact that each expense should be carefully considered. If the purpose of the expense is not in connection with any exempt transaction or other non-taxable purposes, the expense might qualify for deduction under both the VAT Act (89 of 1991) and the Income Tax Act (58 of 1962).

### 3.8 CONCLUSION

It was noted in IN 70 (SARS, 2013b) that in principle, the Warner Lambert SA (Pty) Ltd v CSARS (2003) case is able to be applied under the VAT Act (89 of 1991), in the sense that the expenses incurred in production of income for Income Tax Act (58 of 1962) for the purpose of trade in Section 23(g) of the Income Tax Act (58 of 1962) will usually be incurred “….in the course or furtherance of an enterprise” for VAT
purposes. Vendors are, however, warned to be cautious when drawing their conclusions on the deductibility of CSR, under the VAT law, with reference to income tax legislation and associated case law, as the results may not necessarily be the same (SARS, 2013b).

The cause of the problem regarding the deductibility of input tax was identified as the fact that CSR expenditure is incurred for no consideration. This has significant implications: the making of supplies for no consideration will not be seen as taxable supplies, and thus, to the extent of expenditure being incurred for non-taxable purposes, no input credit will be claimable (SARS, 2013b). The general rule provided in IN 70 (SARS, 2013b) that can be regarded as addressing this problem is that a supply made by a vendor for no consideration, in the course or furtherance of an enterprise, will generally be regarded as a taxable supply. If the term “taxable supply” is met, the input tax will be deductible; therefore one should further investigate whether CSR expenditure can be linked to a company’s taxable supplies. Thus, a critical analysis of court cases specific to VAT needs to be performed, for more guidance regarding the input tax deductibility of CSR expenditure and the link it may have to taxable supplies in the South African context.

A further note is that South African courts, SARS, taxpayers and tax advisers frequently seek authority from various instances of international case law to validate what they acknowledge as the correct treatment in the South African background (KPMG, 2006). A critical analysis will thus need to include both South African and international court cases. For the latter, the international characteristics of the South African VAT system will firstly be compared with other international VAT systems, specifically for the input tax deduction requirement. This will be performed in Chapter 4 so as to determine whether international case law can be utilised to assess the input tax deductibility of CSR expenditure.
CHAPTER 4

A CRITICAL ANALYSIS OF SOUTH AFRICAN AND INTERNATIONAL CASE LAW REGARDING THE INPUT TAX DEDUCTIBILITY OF CSR EXPENDITURE

4.1 INTRODUCTION

In Chapter 3, the South African VAT legislation was examined and it was indicated that input tax will be deductible by a vendor only when expenditure is incurred for the purpose of making taxable supplies in the course of the furtherance of an enterprise. Thus, it is clear that the deductibility of input tax on CSR expenditure will be possible if these criteria are met. It was also noted in Chapter 3 that further consideration of case law is needed in respect of input tax deductibility; due to the limited information available in the VAT Act (89 of 1991) relating to specific situations where input tax may be deducted. As indicated, there are only a small number of important reported VAT cases in South Africa. Fortunately, due to the similarity between the South African VAT Act (89 of 1991) and that of other countries, foreign case law can be used and referred to for guidance on the interpretation of this Act (Gad et al., 2012).

South African common law contains three main strands: Roman Dutch law, English law and South African precedents (Du Bois, 2007:65). The doctrine of precedents basically requires judges to follow legal rulings in previous judicial decisions (Du Bois, 2007:76). Thus, in South African common law, the rulings made in a previous court case are only binding on lower courts; courts with the same jurisdiction need only follow their own rulings. The Tax Court has been established in terms of Section 116 of the TA Act (28 of 2011). This Court’s judgements are only binding on the parties before the court and have only persuasive value in respect of other tax cases (SARS, 2013c). South African courts have utilised international court cases for guidance; however, this practice should be approached with caution. International judgements have been deemed useful; but are only applicable when the international legislation is the same as South African legislation (Stiglingh et al., 2013: 9-10).
The international characteristics of VAT will firstly be examined, followed by the comparability of the South African VAT system with other international VAT systems. This chapter will address research objectives (iii) and (iv) in paragraph 1.3, by critically analysing the South African case law regarding the VAT treatment of overhead expenditure in general and CSR expenditure specifically, as well as evaluating the VAT treatment of overhead expenditure, specifically CSR expenditure, in light of foreign case law. This will be combined with assessing the possible impact of these systems of case law on the deductibility of input tax on overhead expenditure, and in particular, CSR expenditure.

4.2 INTERNATIONAL CHARACTERISTICS OF THE SOUTH AFRICAN VAT SYSTEM

The Organisation for Economic Co-operation and Development ("OECD") holds a leading position in dealing with the international aspects of direct taxes, devising many international instruments for this purpose. The OECD has recently created a framework to address indirect tax issues as well: for the application of the principles of consumption tax on international services and intangibles. As noted in paragraph 3.1, VAT is a form of indirect tax based on consumption; thus the consumption tax the OECD refers to, is the same as VAT. The OECD has recently published new draft guidelines regarding VAT/GST; however, it should be noted that these are only guidelines and not rules (OECD, 2013).

The OECD guidelines were developed so that both OECD and non-OECD countries could implement them. In terms of the OECD guidelines, the general characteristics of VAT are that it is a tax on consumption, levied on a broad base. Further, in principle, the burden of VAT should not rest on the business, and the collection of VAT is performed in a staged process (OECD, 2006). A further description, provided by the Directorate General for Taxation of the European Community, is that VAT is a general tax that applies to all commercial activities, shouldered by the final consumer, charged at a percentage of the price and finally collected fractionally and paid over to the revenue authorities (European Commission, 2013).
There are striking similarities between the VAT systems of different countries. Nevertheless, although most countries have implemented VAT methods with similar principles of operation, many differences still remain. These are not only the result of the continued presence of exemptions and special arrangements that are in place to meet specific objectives, but also of the different approaches followed in the definition of the jurisdiction of consumption. This results in dissimilar understandings of similar concepts, different approaches to time and place of supply, as well as the inconsistent treatment that of mixed supplies (OECD, 2006).

The VAT legislation of South Africa is based on that of New Zealand (Glyn-Jones, 2006). Hence South African VAT is fundamentally a variant of the New Zealand GST (Millar, 2008:199). The European VAT system was consulted when the South African legislation was developed; however in the end, the VAT Act (89 of 1991) was modelled on the New Zealand GST legislation (Van der Zwan & Stiglingh, 2011:330). Even though the wording of the South African VAT legislation is visibly different from the wording of the VAT legislation in Europe and New Zealand, certain key principles in these statutes are frequently similar to those contained in the South African VAT legislation (KPMG, 2006). Discussion regarding the acceptability of arguments in international case law for a South African context must be approached with caution. This is due to the possibility of differences that may exist between the South African, European and New Zealand VAT systems, even though the South African VAT system was modelled after the latter in particular. Europe and New Zealand will be considered for their applicability owing to the key role they assumed in the creation of the South African VAT system. Furthermore, it should be noted that in Europe when there is uncertainty regarding the VAT or income tax treatment of a transaction, the matter is referred to the ECJ for clarity since it is the highest court in Europe. The court interprets EU law and ensures it is applied in the same way in all EU countries (EU, 2013). Owing to this fact, the judgements passed in the ECJ will be used for the purposes of this study, not the underlying judgements of the EU countries.
A critical analysis of international case law is only possible if there are no major differences between the VAT systems on which the judgements are based. New Zealand case law will not be included in the study due to differences between the New Zealand GST Act (41 of 1985) and the South African and European VAT legislation dealing with the input tax deduction. The different results are due to the wording in Section 3A(1) of the New Zealand GST Act (41 of 1985) requiring goods and services to be acquired for the “principal” purpose of making taxable supplies. Neither the VAT Act (89 of 1991) nor the EU’s Sixth Directive (77/388/EEC of 1977) contains this specific requirement. It may have a significant impact on the deduction of input tax and as such this is regarded as a major difference (Van der Zwan & Stiglingh, 2011:337).

To determine the reliability of ECJ judgements, a comparison between the VAT Act (89 of 1991) and the EU’s Sixth Directive (77/388/EEC of 1977) needs to be performed. If there are differences between these pieces of legislation, specifically the requirements regarding input tax deductibility, these may result in an ECJ argument being inappropriate for the purposes of this study. Thus, to determine whether the input tax deduction requirements are consistent in both these VAT systems, the principles, specifically relating to input tax deductions, need to be compared.

A comparison was performed by Van der Zwan and Stiglingh (2011:337) where it was noted that both VAT systems only allowed a deduction of input tax if the expenditure related to taxable supplies, as set out in the VAT Act (89 of 1991) or to taxable transactions, as set out in the EU’s Sixth Directive (77/388/EEC of 1977). It was submitted that no substantial differences between the terms “taxable supplies” and “taxable transactions” were noted. In light of the assessment done, specifically relating to input tax, no significant differences were noted between the requirements enforced on the input tax deduction by the said items of legislation that could possibly impede the application of ECJ judgements in South Africa (Van der Zwan & Stiglingh, 2011:337). This view is further clearly shared by the South African courts as principles of judgements in international legislation are regularly utilised by local courts: for example in the ITC 1744 (2002) case, the judge applied the principle of the
Due to this reassurance about the similarity of the principles on which the EU’s Sixth Directive (77/388/EEC of 1977) is based, the case law can be relied on and the ECJ judgements relating to input tax deductions, together with South African case law, will be critically analysed. The basis of selection of cases for the critical analysis will be provided below.

4.4 CRITICAL ANALYSIS OF CASE LAW

4.4.1 Introduction

The background will be provided for each case identified, whether South African or international (specifically ECJ judgements). The VAT implications will be assessed, followed by an individual application of the precedent set, in the case law, on the potential impact of the judgements concerning the deduction of input tax on CSR expenditure.

4.4.2 Basis of selection

There has been no court case dealing specifically with the input tax deductibility of CSR in South Africa or internationally. As noted in Chapter 3, CSR expenditure usually takes the form of supplies made for no consideration; thus the South African VAT 711 (2009) case dealing specifically with such supplies will be carefully discussed. It should be noted that the other cases selected do not specifically deal with the input tax deductibility of CSR expenditure. However, the judgement noted in these cases can, in principle, be applied to this because CSR expenditure can be seen to form part of the general overhead costs incurred by a company, as explained in paragraph 2.2. For this purpose, case law, with specific reference to the deductibility of input tax, has been selected for the analysis.

The following South African VAT cases in this regard have been selected: VAT 711 (2009), ITC 1744 (2002) and CSARS v De Beers (2012). The CSARS v De Beers (2012) case was presided over in the Supreme Court, this was however initially first presented in the Tax Court as the ITC 1853 (2001) case. In the ITC 1744 (2002) case,
the court relied on an ECJ judgement, BLP Group plc v Commissioner for Customs and Excise (1995), made in 1995. This 1995 judgement will be assessed as part of the ITC 1744 (2002) case, since the latter case was based on the principles of this judgement. A few ECJ judgements have been delivered subsequent to the 1995 case that also necessitates further deliberation. These judgements have started modifying the view held in Europe. The approach taken by ECJ towards dealing with the input tax deduction relating to exempt and non-supplies has developed along different lines in the ECJ itself (Badenhorst et al., 2010). Thus, the critical analysis of two of the subsequent ECJ judgements, responsible for altering the European view, has been incorporated in this study. This has been done to consider the possible updated impact of these judgements on the treatment of CSR expenditure, post the ITC 1744 (2002) case. These additional ECJ judgements to be inspected are the Kretztechnik AG v Finanzamt Linz (2005) and the Skatteverket v AB SKF (2009) case. These ECJ judgements, even though they specifically deal with share issue costs which as exempt supplies, have been chosen due to their specific reference to overhead costs and the input tax deductibility thereof. Further, in the ITC 1853 (2001) case referred to above, the international court case Skatteverket v AB SKF (2009) was specifically cited; therefore the researcher has deemed it appropriate to include the latter for purposes of the critical analysis even though it dealt with exempt share issue costs.

4.5 SOUTH AFRICAN CASE LAW

4.5.1 VAT 711 (2009)

4.5.1.1 Background facts

The appellant was KCM, an interdenominational Christian Ministry and an association not for gain. Its headquarters are situated in the USA and it has established branches in various countries, including South Africa. KCM operated a small bookstore, selling books, DVDs and other religious material. KCM utilises the turnover-based method; the sales from the above mentioned activities comprise no more than 15% of KCM’s total income. KCM makes these taxable supplies in the course of carrying out its objectives to promote, minister and spread the Word of God. The major source of income for KCM comprises donations. The appellant claimed input tax credits on the religious material distributed free of charge. SARS conducted
a VAT audit on the appellant’s tax affairs. An assessment was issued in which SARS disallowed the input tax deducted, stating that it was for non-taxable supplies. KCM objected to the disallowance and appealed to the Tax Court. The appeal was, however, dismissed in the Tax Court.

4.5.1.2 VAT Implications

The issue identified by the Tax Court was whether the appellant, KCM, was entitled to claim input tax on goods distributed free of charge. The question stated by the Tax Court was whether the costs incurred on which VAT was paid, were acquired in terms of the definition of input tax in Section 1 of the VAT Act (89 of 1991) being “wholly for the purpose of consumption, use or supply in the course of making taxable supplies” by the appellant. It was stated that a vendor would only be able to deduct tax incurred for goods and services acquired for the purpose and extent of making these taxable supplies. The appellant sought to rely on Section 10(23) of the VAT Act (89 of 1991) to overcome this problem; it states that the value of a supply shall be deemed to be nil when no consideration is made. If this section was applicable this would have ensured that the input tax credits could still be claimed by KCM in the absence of any consideration.

Judge Van Oosten J, however, was not in agreement and stated that Section 10 of the VAT Act (89 of 1991) deals with the value of supply of goods and services; the purpose of sub-section 23 is only to deem the value of a supply to be nil in some instances. The court disallowed the input tax credit, arguing that the main activities of the appellant were free of charge and gratuitous. The court stated that a gratuitous act cannot, when considering the provisions of the VAT legislation, constitute a supply of goods and services for a consideration. Thus, the deduction of input tax was denied. In this case, SARS argued that the free distribution of the magazines was not a supply of goods for a consideration and thus it did not comprise an enterprise.

4.5.1.3 Application on CSR expenditure

The interpretation of the VAT Act (89 of 1991) in this court case has major implications for vendors supplying goods or services free of charge, not only for associations not for gain. In effect the court said that activities involving the supply of goods or services for no consideration do not comprise an enterprise, so that the input
tax credit should be denied on the related costs (Badenhorst, 2009). Even though the Tax Court only has persuasive value and is only binding on the parties involved (SARS, 2013c), the judgement created concerns that this may represent the approach that SARS may follow in the future (PwC, 2010). This judgement related to a non-profit organisation; however its impact might be widespread. This is due to the fact that the input tax requirements of the VAT Act (89 of 1991) do not differentiate between non-profit organisations and commercial business. This treatment will, however, be in conflict with the practice which has applied since VAT was introduced, being that vendors can deduct input tax on supplies made free of charge. The judgement has, however, created the risk that input tax may not be deductible when supplies are made for no consideration (PwC, 2010). The view held by PwC (2010) is, nevertheless, that VAT vendors expending VAT on CSR will still be entitled to the input tax credits, provided these were incurred in the course or furtherance of the vendor’s enterprise. This view is in line with the general rule created in the recent IN 70 (SARS, 2013b: that the CSR expenditure, as a supply made for no consideration, must be incurred in the course or furtherance of an enterprise and will then be deductible, taking into account certain facts and circumstances.

4.5.2 ITC 1744 (2002)

4.5.2.1 Background facts

The appellant, a registered VAT vendor, making taxable supplies, had been incorporated to exploit a patent for the manufacture of steel shipping containers suitable for road freight. The appellant needed capital to manufacture the containers and in order for it to raise the capital, the services of a company specialising in the venture capital market were employed. A placement fee equal to 20 per cent of the capital raised was paid for the services and VAT was levied on this service. The appellant claimed an input tax deduction on these services for the sale of shares in it. The Commissioner for SARS rejected the input tax deduction, stating that this was for the supply of financial services and as such an exempt supply. The appellant appealed to the Cape Tax Court. The appeal was dismissed and the assessment confirmed.
4.5.2.2 VAT implications

The question before the court was whether the appellant was allowed to deduct the VAT on the placement fee. The Commissioner for SARS relied on Section 2(1) of the VAT Act (89 of 1991) in terms of which the allotment, issue and transfer of ownership of equity securities is deemed to be a financial service. This, in turn, is an exempt supply in terms of Section 12(a) in the VAT Act (89 of 1991). The appellant, however, still claimed the input tax, contending that even though the supply of financial services was exempt, the input tax should be allowed, owing to the close connection between the sale of the shares and the manufacturing of the containers, which would not have been possible had the capital not been raised. The court took into consideration the definition of input tax in Section 1, as well as Section 17(1) of the VAT Act (89 of 1991), to determine whether the input tax on the placement fee was deductible.

Judge Conradie, J was not in agreement with the argument of the appellant. The judge relied on the ECJ judgement in the BLP Group plc v Commissioner for Customs and Excise (1995) case and supported this with a reference to the international Customs and Excise Commissioners v UBAF Bank Ltd (1955) case. BLP Group plc was a management holding company which had disposed of shares in its subsidiary. Professional fees were incurred by BLP Group plc for the disposal of the shares. BLP Group plc sought to deduct as input tax the VAT paid on these fees. The ECJ held that a direct and immediate link should exist between the goods and services in question and the taxable transaction. The ECJ further held that where services are used for an exempt transaction by a taxpayer, no input tax will be deductible even if the ultimate purpose of the transaction is the making of taxable supplies. In Customs and Excise Commissioners v UBAF Bank Ltd (1955), the respondent bank carried on an equipment leasing business. Shares in three companies were acquired to extend the business and fees were paid regarding this acquisition. The court of appeal held that there was a sufficient or direct link that existed between the fees paid and the taxable supplies of the respondent bank, being the business of equipment leasing. The direct and immediate link was thus applied in favour of the UBAF Bank.

Relying on the principles in these two ECJ judgements, Conradie, J applied the “direct and immediate link” test created in the BLP Group plc v Commissioner for Customs
and Excise (1995) case and held that the said link existed between the placement fee and financial services, which is an exempt service; not between this fee and the taxable supplies of the manufacture of shipping containers. The input tax could thus not be deducted.

4.5.2.3 Application on CSR expenditure

Even though this is a Tax Court ruling and SARS is not bound to follow a decision in the Tax Court (PwC, 2010; SARS, 2013c), this ruling is favourable to SARS. A sufficient direct link should therefore exist between a CSR expense and taxable supplies of a business for input tax to be deductible. A vendor must ensure that a direct and immediate link between CSR expenditure and the making of taxable supplies can be upheld. Thus, a vendor must closely consider the specific facts and circumstances around CSR expenditure and whether it can be directly linked to taxable supplies. When considering the direct and immediate link further, it is, however, still debatable exactly how close the link must be between expenditure incurred and the taxable supplies made so as to qualify for the input tax deduction (Clegg & Wiid, 2012:55). This should be kept in mind by the vendor when CSR expenditure is undertaken.

4.5.3 CSARS v De Beers (2012)

4.5.3.1 Background facts

The respondent, De Beers, a listed company, mines for and sells diamonds internationally. In November 2000, De Beers was approached by a consortium. A complex transaction was proposed in terms of which a new company would be established. The new company would become the holding company of De Beers, as well as the holding company of another linked Swiss firm. The newly established company, incorporated in Luxembourg, would own De Beers’ diamond operations as well as all associated holdings. De Beers engaged NM Rothschild and Sons Ltd (“NMR”). NMR is a London-based independent financial advisor, involved to advise the board whether the deal was fair and reasonable, which was required in terms of company law. De Beers also simultaneously appointed various South African advisors and service providers to assist in the proposed transaction.
De Beers only claimed the VAT incurred on the payments to the South African advisors and service providers. It did not account for any VAT on the services charged by NMR. The Commissioner for SARS determined that there was VAT payable on the NMR service fee since it had been regarded as imported services in terms of Section 7(1)(c) of the VAT Act (89 of 1991) in an assessment dated 18 October 2004. Furthermore, the Commissioner determined that the VAT charged by the local services providers did not qualify as input tax as the services were not incurred in the course or furtherance of De Beers’ enterprise and disallowed the deduction. De Beers lodged an appeal with the Tax Court regarding this assessment. In the ITC 1853 (2001) Tax Court ruling, the court held that the services provided by NMR were not imported services, because they were utilised by De Beers for the purpose of making taxable supplies in the course or furtherance of its enterprise of mining and selling of diamonds. The court, nonetheless, determined that the local services were not deductible, save in so far as one of the service providers, Weber Wentzel Bowens (“WWB”), was concerned, as these costs were not incurred for the enterprise of De Beers. The Commissioner for SARS appealed against the finding of the Tax Court; specifically against the findings that NMR services did not constitute imported services and that the local services rendered by WWB were constituted as deductible. De Beers cross-appealed to the Supreme Court of Appeal (“SCA”) on the finding that payments to the local providers, excluding WWB, did not constitute deductible input tax. The SCA held that the same question needed to be answered in the appeal and cross appeal, the question being whether the services acquired by De Beers were required for the purpose of making taxable supplies, which meant supplying goods or services in the course or furtherance of an “enterprise.”

4.5.3.2 VAT implications

This specific case dealt with the deductibility of input tax and the meaning of “enterprise” as defined in Section 1 of the VAT Act (89 of 1991). The question before the Supreme Court was whether the services acquired by De Beers, both those of NMR and local services, were acquired for the purpose of making taxable supplies in that enterprise. It was held that the NMR services were not acquired as part of De Beers’ overhead expenditure; they were supplied so that the board of De Beers could comply with its legal obligations. The answer was similar for the local services
provided. Thus, the impact of this was that De Beers could not deduct the input tax on the local services and VAT was payable on the imported services from NMR. This was due to the court being of the opinion that none of these services were acquired for the purpose of making taxable supplies by De Beers for its enterprise. The SCA found that in the circumstances of this case, De Beers was not a dealer in shares, so that the receipt of dividends or the holding of shares did not fall within the definition of an enterprise as defined in Section 1 of the VAT Act (89 of 1991). Hence the court held that for the purposes of the VAT Act (89 of 1991) the enterprise of De Beers was the mining, marketing and selling of diamonds.

The court did not follow the same ground as in the ITC 1744 (2002) case, which dealt with the preparatory activities relating to the conduct of an enterprise. Furthermore, it did not deal with the issues raised in the ECJ judgement of the Kretztechnik AG v Finanzamt Linz (2005) case. This case dealt with the cost of new shares and the argument that these issue costs are regarded as part and parcel of the enterprise and thus of the taxpayer’s economic activity (Morphet & Lewis, 2011). Kretztechnik AG v Finanzamt Linz (2005) is discussed under the international cases below.

4.5.3.3 Application on CSR expenditure

In the SCA case it was held that the expenditure for the services was not acquired in the ordinary course of the “enterprise” of De Beers as part of its overhead expenditure. The appellant argued that it had been obliged to incur the expenses for the services in terms of Section 311 of the Companies Act (61 of 1973). Furthermore, it contended that the services were acquired as a necessary input giving rise to overhead expenditure, since De Beers could not continue to operate its enterprise without complying with the legal requirement to acquire the services of NMR. However, the SCA was unpersuaded and disagreed with the appellant’s argument.

It has been noted earlier in the study that King III (2009) is not a set of official legal documents; however the JSE requires listed companies to disclose how they have been complying with these documents in their annual financial statements. Thus, costs incurred for CSR by a listed company to meet sustainability, for example, could have the main objective of meeting King III (2009); therefore the argument might be that this CSR expenditure was incurred to meet the requirements of law, similar to
paragraph 2.3.3 above where it was determined that B-BBEE costs are incurred in terms of the law.

Although it could be argued that SARS followed a narrow interpretation in arriving at its decision in the De Beers’ (2012) case, vendors need to be aware of the implication. The principles set out in this SCA ruling should be taken note of since the fact that overhead expenditure or services are imposed on the vendor by law does not necessarily mean that the goods or services have been acquired for the purpose of making taxable supplies (McGurk, 2012).

SARS may reconsider its past views in relation to CSI and BEE expenditure although this expenditure should not constitute separate non-taxable activities, specifically where these activities can still be linked to the business of the vendor (Smuts, 2012). It should be noted, however, that Judges Navsa JA and Van Heerden JA did emphasise the facts of the present case were unique; therefore the court’s decision can be regarded as unique and is hardly likely to be duplicated (CSARS v De Beers (2012)). This statement made by the court provides slight reassurance that this argument will not be used in future court cases.

4.6 INTERNATIONAL CASE LAW

4.6.1 Kretztechnik AG v Finanzamt Linz (2005)

4.6.1.1 Background facts

Kretztechnik AG was an Austrian incorporated company listed on the Frankfurt stock exchange. The company developed and produced medical equipment. The company incurred costs in becoming listed on the stock exchange. Kretztechnik AG claimed a deduction of the input tax on these expenses. The tax authorities denied this deduction, stating that this was for share issue costs and therefore exempt. The judgement in ITC 1744 (2002) was based on the same grounds; Kretztechnik AG appealed to the ECJ for clarity.
4.6.1.2 VAT Implications

Two questions were asked by the court: whether the issuing of shares was a supply and whether the input tax on the service relating to the issue of shares was deductible. The court held that a new share issue did not constitute a supply, based on the fact that the company does not supply a service when shares are issued for a share price, as no transfer of any existing rights occurs. Even though it was held that the issuing of shares is not a supply, the court held that all the costs could be allocated to overheads, provided that the transactions took place for the purpose of business, and these costs were thus deductible. This is because the court stated that the overheads formed part of the component of the price of the products, which benefited the business as a whole. Thus, the supplies have a direct and immediate link to the business as a whole. The court allowed Kretztechnik AG to deduct the costs, to the extent of the entity’s taxable transactions. The argument for this was that the costs were for the benefit of its taxable activity. The taxable activity of Kretztechnik AG was the manufacturing of medical equipment; thus the costs incurred formed part of the company’s overheads and constituted a component of the price of the products that were taxable and marketed by it (Badenhorst et al., 2010).

4.6.1.3 Application on CSR expenditure

In the Kretztechnik AG v Finanzamt Linz (2005) case, the ECJ agreed and concluded that the issue of new shares are carried out to increase the capital of the company. As such this is for the benefit of economic activity in general, and could thus be regarded as overheads. Accordingly, this led to the deductibility of input tax in the same way as any other overhead. Thus, vendors only carrying out taxable supplies are permitted to deduct this in full, whereas partially exempt traders would only be able to deduct the relevant percentage (Angiolini, 2005). It has been determined in paragraph 2.1 above that CSR expenditure can be regarded as an overhead cost, since it does not directly link to the individual products or services that the business produces. Furthermore, CSR expenditure is directly linked to the whole economic activity of a business because, for example, when complying with sustainability in terms of King III (2009) this will apply to the whole business’s legal requirement. Thus, the principle in Kretztechnik AG v Finanzamt Linz (2005) of the deduction of input tax relating to overhead costs can be applied to CSR expenditure.
4.6.2 Skatteverket v AB SKF (2009)

4.6.2.1 Background facts

The share company AB SKF was a Swedish parent company of an industrial group actively involved in the management of these subsidiaries. The activities of the industrial group were carried on in many countries. A fee was charged by AB SKF for the management services rendered. The Swedish parent company then decided to restructure its group. It disposed of two subsidiaries and ceased providing the specific management services. AB SKF deducted the full input tax on the services provided in respect of the disposal of the two subsidiaries. AB SKF made use of a preliminary ruling procedure available in Sweden to determine whether the VAT would be recoverable (Woolich, 2010). The preliminary ruling stated that AB SKF would be entitled to recover the VAT. The Swedish court appealed the preliminary ruling and referred the matter to the ECJ.

4.6.2.2 VAT implications

In the discussion of the input tax deductibility, it was noted in court that the deduction system is intended to relieve the trader of the burden of VAT and ensure neutrality; a concept also noted in other ECJ judgements, for example the CIBO participations SA v Directeur regional des impôts du Nord-Pas-de-Calais (2001) case. The court stated that according to settled case law, the direct and immediate link between the input and the output transaction or transaction giving rise to entitlement to deduct, needed to be determined. This is necessary to entitle a taxpayer to deduct input tax. The court determined that the transaction was linked to an exempt transaction. The transactions in shares, interests in companies or associations are exempted from VAT under Article 13B(d)(5) of the Sixth Directive (77/388/EEC of 1977). It was further noted that it is also accepted that a taxable person can deduct input tax even when there is no direct or immediate link between a specific input and output transaction, where the costs are general costs. At the end, the court did provide AB SKF with the opportunity to argue that the aim was to obtain funding for the business as a whole and therefore a portion of the expense could be seen as a general cost to the business.
4.6.2.3 Application on CSR expenditure

The view held regarding the VAT deductibility of incurred costs to transfer existing shares was the same as the view held in the BLP Group plc v Commissioner for Customs and Excise (1995) judgement. Noteworthy in this judgement is that it is accepted that a VAT vendor can deduct input taxes when these relate to general costs. Thus, vendors will need to be able to demonstrate to SARS that their specific CSR expenditure comprises general costs, incurred for the main purpose of making taxable supplies.

In the ITC 1853 (2011) case, the primary appeal of De Beers heard in the Tax Court, it was stated, with support adduced from the Skatteverket v AB SKF (2009) case, that if a transaction has a direct link with the organisational activity of the appellant, it would constitute a direct, permanent and necessary extension of the taxable activity. This will result in the activity falling within the scope of VAT.

4.7 CONCLUSION

In the VAT 711 (2009) case, SARS argued that the free distribution of the magazines was not a supply of goods for a consideration and thus it did not comprise an enterprise. Clarity regarding the SARS view on this has been provided by IN 70. The general rule set out there is that a supply made for no consideration, must be incurred in the course or furtherance of an enterprise and then the input tax will be deductible (SARS, 2013b). In the light of the decision reached in the De Beers (2012) case, the current policy for SARS is, however, still to allow the deduction of input tax on an expense, only when a direct and immediate link between the expense and the taxable supply exists. The ultimate purpose of incurring the expense is ignored (Holdstock, 2013). SARS has thus far ignored the subsequent ECJ judgements, specifically the Skatteverket v AB SKF (2009) and the Kretstechnik (2005) cases, which override the judgement relied on in the ITC 1744 (2002) case (Badenhorst et al., 2010). The current policy of SARS is to follow the ITC 1744 (2002) decision, which requires a direct or immediate link to be established to a taxable supply. This policy regards the ultimate purpose of incurring the cost as irrelevant. This principle is followed, even though the definition of input tax does not state this requirement, due to it only specifying that the fact that cost should be acquired for the purpose of use,
consumption or supply in the course of making taxable supplies. It does seem that this area of law is under development. It should also be noted that the SCA did not follow certain international precedents in the CSARS v De Beers (2012) case and thus SARS may continue to follow the same restrictive approach in the future (Gad et al., 2012).
CHAPTER 5

CONCLUSION AND IDENTIFICATION OF FUTURE RESEARCH AREAS

5.1 INTRODUCTION

The main purpose of this study was to provide an analysis of the factors that influence the South African VAT treatment of CSR expenditure. Objectives were set to be able to sufficiently answer the problem statement. Chapter 2 explored the nature of overhead expenditure, particularly CSR expenditure. In Chapter 3, the treatment of the input tax on overhead expenditure, specifically CSR expenditure again, was examined. The South African VAT Act (89 of 1991) and Income Tax Act (58 of 1962) were inspected to shed light on the problem of the input tax deductibility of overhead expenditure, particularly related to CSR. In Chapter 4, a critical analysis of the South African and international case law, specifically ECJ judgements relating to the deductibility of input tax, was performed and applied to CSR expenditure. This chapter will address research objective (v) in paragraph 1.3 by furnishing the conclusion and recommendations on the factors that influence the South African VAT treatment of CSR expenditure. It further contains a summation of the achievement of the research objectives, as well as suggestions for future research. Finally, a conclusion regarding the problem statement will be offered.

5.2 ACHIEVEMENT OF RESEARCH OBJECTIVES

To be able to draw conclusions, each specific research objective has been addressed and the conclusions drawn, discussed below:

i) To explore and understand the nature of overhead expenditure, specifically CSR expenditure.

- Chapter 2 provided information showing that companies are becoming more involved in CSR and have specific CSR objectives. It was noted that companies are incurring overhead costs, CSR expenditure in particular, to
meet these CSR objectives more frequently. Overhead expenditure was explored and explained as expenditure incurred that relates to the company as a whole. The meaning and definition of CSR were provided; furthermore the legal framework for CSR in South Africa was inspected and BEE as an example of CSR was investigated. It was also noted that CSR expenditure may possibly lead to financial return possibilities for a business and that CSR may well meet the fiduciary responsibilities of management. The various ways that companies engage in CSR expenditure in practice were also investigated. It was emphasised that companies should interpret what CSR means in the context of their own business. Furthermore, the VAT and income tax implications of the companies’ CSR objectives should be considered due to the fact that CSR expenditure might not be deductible for income tax and VAT purposes in all scenarios.

ii) To explore the deductibility of input tax on overhead expenditure, specifically CSR expenditure.

- Chapter 3 provided information regarding the deductibility of input tax on overhead expenditure, specifically that related to CSR. This was explored by examining the applicable legislation, both the VAT Act (89 of 1991) and the Income Tax Act (58 of 1962). It was noted that in principle, the Warner Lambert SA (Pty) Ltd v CSARS (2003) case may be applied under the VAT Act (89 of 1991), in the sense that the expenses incurred in production of income for the Income Tax Act (58 of 1962) for the purpose of trade in Section 23(g) of the Income Tax Act (58 of 1962) will usually be incurred “in the course or furtherance of an enterprise” for VAT purposes. A warning for vendors was however noted: that caution should be applied when drawing their conclusions on the deductibility of CSR, under the VAT law, with reference to income tax legislation and associated case law, as the results may not necessarily be the same. The problem for the deductibility of input tax lies in determining whether a supply made for no consideration, for example CSR expenditure, is made in the course or the furtherance of an enterprise. For any expense to meet this requirement, the expenditure should have been undertaken in the making of taxable supplies.
iii) To critically analyse VAT legislation and South African case law regarding the treatment of overhead expenditure in general and CSR expenditure specifically.

- In Chapter 3, it was determined that there is limited guidance provided in the VAT Act (89 of 1991) regarding the deductibility CSR expenditure. Thus, South African tax cases dealing specifically with the deduction of input tax were identified to provide clarity when considering the purpose of CSR expenditure and therefore the input tax deductibility thereof.

- A critical analysis was performed in Chapter 4 to assess how the precedent set in South African tax cases may be applied on CSR expenditure. The following case law was analysed and applied to CSR expenditure in Chapter 4:
  
  o In the VAT 711 (2009) case, it was determined that when supplies are not made in the making of taxable supplies, the input tax will not be deductible and furthermore, if the main activities of the company are gratuitous and free of charge, expenditure incurred will not be seen as “wholly for the purpose of consumption, use or supply in the course of making taxable supplies” in terms of Section 1 of the VAT Act (89 of 1991). The impact of the judgement of this case in isolation would have been that the input tax credit on CSR expenditure would have been denied, as this expenditure is a supply of goods or services for no consideration. Subsequent to this judgement, IN 70 was published by SARS: this determines that input tax resulting from CSR expenditure, as a supply, made for no consideration, will be deductible (reliant on specific facts and circumstances) if incurred in the course or furtherance of an enterprise.
  
  o In the ITC 1744 (2002) case the court held that a direct and immediate link existed between the placement fee incurred by the appellant and financial services, which constitute an exempt service; not the taxable supplies of the manufacture of shipping containers. The input tax could therefore not be deducted. Thus, from this judgement it is clear that there needs to be evidence of a direct and immediate link between
expenditure incurred and the making of taxable supplies, for input tax to be deductible. Therefore, if this ruling is applied on the treatment of input tax on CSR expenditure, the vendor will need to provide a sufficient direct and immediate link between the CSR expense, and the taxable supplies of its business. This direct and immediate link test can be demonstrated due to the nature of CSR expenditure being an overhead expense incurred for the benefit of the company as a whole, as explained in paragraph 2.1 and therefore directly related to all taxable supplies of the business.

- In the light of the recent CSARS v De Beers (2012) case, the judgement made creates the questionability of the input tax deductibility of overhead expenditure, specifically CSR expenditure. This question arose due to a matter emphasized in the case: that of an expense being incurred for the purpose of making taxable supplies for its specific enterprise, with the said specific enterprise being the main business of the project. For example, in the circumstance concerning De Beers, it was with regard to the mining, marketing and selling of diamonds. Therefore, the case created the situation where SARS might argue that CSR expenditure is not incurred for the main business of an enterprise and therefore that the input tax will not be deductible. It should however be recalled that the court did emphasise the facts of this case were unique and therefore it should not be used as a precedent for other transactions.

iv) To evaluate the VAT treatment of overhead expenditure, specifically CSR expenditure, in light of foreign case law.

- It was concluded that foreign case law, specifically ECJ judgements, could be used in the critical analysis performed, due to the similarities existing between the South African and the European VAT systems regarding the deduction of input tax. A critical analysis of the ECJ judgements was thus performed in Chapter 4. This identified the treatment of input tax in the light of the foreign precedent as follows:
In the Kretstechnik (2005) case, the court stated that overheads form part of the component parts of the price of the products and thus have a direct and immediate link to the whole economic activity of a business; therefore, the input tax on the overhead expenditure was deductible. As indicated in paragraph 2.1 of this study, CSR expenditure may be regarded as an overhead cost, as it does not link directly to the individual products or services that the business produces; therefore the input tax will be deductible.

The case of Skatteverket v AB SKF (2009) concurred with the judgement regarding the VAT deductibility of incurred costs to transfer existing shares as in the case of BLP Group plc v Commissioner for Customs and Excise (1995). This judgement further accepted that a VAT vendor can deduct input taxes when these relate to general costs. Therefore, a vendor needs to demonstrate to SARS a direct and immediate link between a CSR expense and the taxable supplies of a business in order to obtain the input tax deductibility thereon. This direct and immediate link test may be demonstrated, in a manner similar to the application in the ITC 1744 (2002) case above. In short, CSR expenditure is considered as an overhead cost and therefore has a link to all taxable supplies of the business.

v) To make conclusions and recommendations on the factors that influence the South African VAT treatment of CSR expenditure.

- Recommendations, suggestions for future research and conclusions are dealt with in paragraphs 5.3, 5.4 and 5.5 below.

5.3 RECOMMENDATIONS

In order to address the factors that influence the South African VAT treatment of input tax on CSR, the following recommendation is put forward:

- It has been noted that the IN 70 (SARS, 2013b) recently published by SARS deals with supplies made for no consideration; however, IN 70 (SARS, 2013b) does not provide an in depth view of the facts and circumstances surrounding the specific
requirements for the VAT treatment of CSR expenditure. SARS further sets out that there is no single test that may be applied on the treatment of CSR expenditure, except for this general rule which appears in the IN 70 (SARS, 2013b). Thus, in order to address the factors that influence the South African VAT treatment of input tax, it is recommended that SARS release an Interpretation Note that provides specific examples of CSR expenditure, such as B-BBEE costs and the input tax treatment that these expenditures will result in.

5.4 SUGGESTIONS FOR FUTURE RESEARCH

A few potential topics for further research have been identified during the investigations of this study:

- This study did not assess the CGT and donations tax impact for income tax purposes of CSR expenditure. Specific further research could include the CGT and donations tax treatment of expenditure incurred in line with other sector charters that will affect the B-BBEE scorecard of an entity.

- In the current study CSR expenditure was examined as a whole. This is a limitation, as the treatment of each individual type of CSR expenditure was not examined. Thus, for future research the different types of CSR expenditure should be identified and selected, and the possible tax implication of each then assessed.

5.5 CONCLUSION

Taxpayers are moving toward becoming corporate citizens and are expending more and more money on CSR as a result of this fact. CSR is a tool by means of which financial benefits can be created for a company if utilised correctly. The problem identified regarding CSR expenditure is that the expenditure incurred by the vendor, in accordance with its CSR objectives, is not always deductible, whether it is to comply with statutory requirements or incurred as part of a voluntary programme. The deductibility of input tax on the CSR expenditure depends on the facts and circumstances of each case. Therefore, it is of key importance for the vendors to realise that the CSR expenditure they are contemplating incurring may have possible VAT implications.
SARS has thus far ignored the ECJ judgements subsequent to ITC 1744 (2002) and the current policy still requires a direct or immediate link to be established to a taxable supply despite the definition of input tax in the VAT Act (89 of 1991) not having this requirement. The VAT Act (89 of 1991) only specifies the fact that cost should be acquired for the purpose of use, consumption or supply in the course of making taxable supplies. Even though it does seem that this area of law is under development, the South African SCA did not follow certain international precedents in the CSARS v De Beers (2012) case; thus it seems that SARS may continue to follow the same restrictive approach in the future regarding the deductibility of input tax.

The focus of this study has been to identify and assess the possible factors that influence the South African VAT treatment of CSR. In this study, it was determined that factors influencing the South African VAT treatment firstly concerned whether a supply made for no consideration, specifically CSR expenditure, was made in the course or furtherance of an enterprise. The second factor identified was whether the CSR expenditure incurred can be proven to have a direct or immediate link to the making of taxable supplies in the course or furtherance of the vendor’s enterprise. The study also drew attention to the issue that vendors should not arrive at their conclusions regarding CSR expenditure under the VAT law with reference to the income tax legislation and associated case law, as the results may not necessarily be the same. By the achievement of each research objective (paragraph 5.2 refers), it may be concluded that the factors that influence the South African VAT treatment of CSR have been adequately analysed.

In conclusion, one could observe that while the maxim of “doing good is good for business” has been established, the other, somewhat wry maxim that “no good deed goes unpunished” is applicable in that SARS may well deny the deduction of input tax on the expenditure incurred for these deeds. Thus vendors should utilise the factors identified in this study when incurring CSR expenditure to steer clear of the possible penalties that they may incur.
BIBLIOGRAPHY


Acts see South Africa.

Acts see Europe.


Europe. 1995. BLP Group plc v Commissioner of Customs and Excise ECJ C-4/94.
Europe. 2001. CIBO participations SA v Directeur regional des impôts du Nord-Pas-de-Calais. ECJ Case C-16/00.

Europe. 2005. Kretztechnik AG v Finanzamt Linz ECJ Case C-465/03.

Europe. 2009. Skatteverket v AB SKF ECJ Case C-29/08.


Law reports see South Africa.

Law reports see Europe.


South Africa 1924. Commissioner for Inland Revenue v George Forest Timber Company Ltd 1924 (1) SATC 20.

South Africa. 1926. British Insulated and Helsby Cables Ltd v Atherton 1926 (AC) 205 at 213, 10 TC 155.

South Africa. 1936. Income Tax Case No. 368 1936 (9) SATC 211.

South Africa. 1936. Port Elizabeth Electric Tramway Co Ltd v Commissioner for Inland Revenue 1936 CPD 241.


South Africa. 1946. New State Areas Ltd v Commissioner for Inland Revenue 1946 AD 610.
South Africa. 1948. Sub-Nigel Ltd v Commissioner for Inland Revenue 1948 (4) SA 580 (A) 15 SATC 381.

South Africa. 1955. Commissioner for Inland Revenue v Genn & Co (Pty) Ltd 1955 (3) SA293(AD) [1955] 3 All SA 382 (a) 20 SATC 113 (A).


South Africa. 1975. Caltex Oil (SA) Ltd v Secretary for Inland Revenue (1975) 1 SA 665(A) 37 SATC 1.


Woolich, R., Burgess, M., Thompson, D. & Allen, L. 2010. European Court of Justice SKF: new entitlement to recover VAT on costs of share sales.
Date of access: 17 Sep. 2013.
