

Evaluating alternative VAT apportionment approval mechanisms for implementation in South Africa

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ABSTRACT

The apportionment methodology, as it relates to input tax under the South African VAT system, is often criticised by authors as being impractical or contentious. The prescribed standard turnover-based method, which is the only pre-approved method in South Africa, does not seem to yield a fair reflection of the tax application of all entities. However, alternative apportionment methods are granted with prospective effect which may be counter-intuitive and unjust. Therefore, it was valuable to consider the possibility of implementing an alternative apportionment methodology, or elements thereof, by investigating the methods adopted in other countries.

For this reason, the VAT system implemented in South Africa as it relates to input tax was analysed in detail, specifically focussing on the apportionment methodology and the complications relating thereto. This was followed by an in-depth analysis of the GST apportionment methodology applied in Australia and New Zealand, respectively. The analysis of the systems implemented in the respective countries allowed for a comparison to be drawn between the various apportionment systems. This comparison was based solely on the principles of a good tax system relevant to VAT which is also discussed in this study.

The comparison revealed that none of the apportionment methodologies conforms to all the principles regarded as being relevant to a value-added tax and consequently all three systems can be adjusted to better adhere to these principles. The evaluation further revealed that there is a trade-off between the various principles as and when applied to each apportionment system and the interested parties. Therefore, on the basis of the comparison between the apportionment methodology implemented in South Africa, Australia, and New Zealand, respectively, and specifically focussing on the principles of a good tax system, it was evident that none of these systems provide optimal results. In the end it came down to which system balances the interests of the taxpayer and the interest of the fiscus the best, rather than to prove the single most optimal system. It was further remarked that the apportionment methodology that balances these interests the best varies for each country by reason of the different tax policies adopted by the tax authorities of the respective countries. It was then concluded that South Africa's VAT apportionment methodology provides a satisfactory balance as it protects both the interests of the taxpayer and the interests of the fiscus in the long term. Nevertheless, this study revealed that an element of the New Zealand apportionment system may be valuable to consider for implementation in South Africa.

Key terms: Apportionment ratio, goods and services tax, input tax, taxable supplies, value-added tax

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LIST OF ABBREVIATIONS

ACCA	Association of Chartered Certified Accountants
AICPA	Association of International Certified Professional Accountants
ATO	Australian Taxation Office
BAS	Business Activity Statement
BGR	Binding General Ruling
GIFT	Global Initiative for Fiscal Transparency
GST	Goods and Services Tax
GST	General Sales Tax
GSTR	Goods and Services Tax Ruling
ICC	International Chamber of Commerce
IRD	Inland Revenue Department
ITEP	Institute on Taxation and Economic Policy
NZCS	New Zealand Customs Service
OECD	Organisation for Economic and Co-operation and Development
SAICA	South African Institute of Chartered Accountants
SARS	South African Revenue Service
SCA	Supreme Court of Appeal
STB	Standard turnover-based
TCB	Transaction count-based
VCR	VAT Class Rulings
VAT	Value-added Tax

WST Wholesale Sales Tax

1 Chapter 1 Introduction

1.1 Introduction

Value-added tax (VAT) is an indirect tax that was implemented in South Africa on 29 September 1991. The purpose of VAT is to tax the consumption of goods and services in the economy (SARS, 2021b). This tax is focused on the domestic consumption of goods and services, as well as the importation of goods into South Africa, and is designed so that the end consumer is liable for the tax (Mandy, 2022). The fiscus raises revenue from this tax by requiring businesses carrying on an enterprise to register for VAT and to then charge output tax on the goods or services supplied by that business to its customers. VAT should also be levied, in certain circumstances, on the importation of services into South Africa. An enterprise as defined in section 1(1) of the Value-Added Tax Act 89 of 1991 (hereafter referred to as the VAT Act) includes any activity which is carried on continuously by a person in, or partly in, South Africa and in the course of which goods or services are supplied to another person for consideration. VAT registered businesses are allowed an input tax deduction on any VAT charged to it and, in limited circumstances, from a supply made by a non-vendor for any goods or services acquired to make taxable supplies (SARS, 2021b). These input tax deductions, in principle, ensure that the tax burden rests with the final consumer and is not imposed on the business itself.

Input tax is defined in section 1(1) of the VAT Act as the VAT incurred on the supply of goods or services to the vendor, VAT incurred on the importation of goods, and, in limited circumstances, VAT on excise duty goods. In addition, the definition includes, *inter alia*, the deemed input tax deduction on the acquisition of certain second-hand goods. Section 17(1) of the VAT Act stipulates that a vendor acquiring or importing goods or services partially for consumption, usage, or supply, in the course of making taxable supplies and partially for an alternative use that is not in the course of making taxable supplies, are allowed to claim input tax only to the extent that the above-mentioned goods or services were acquired for making taxable supplies. However, if the taxable use is equal to or exceeds 95% of the total consumption the *de minimis* rule will apply allowing the vendor a full input tax deduction (SARS, 2015:2). Section 17(1) was included in the VAT Act to ensure that taxpayers are only able to claim input tax on expenditure incurred for the making of taxable supplies, thereby protecting the South African Revenue Service (hereafter referred to as SARS) from taxpayers claiming unreasonable amounts of input tax. Section 17(1) reads as follows:

Where goods or services are acquired or imported by a vendor partly for consumption, use or supply (hereinafter referred to as the intended use) in the course of making

taxable supplies and partly for another intended use, the extent to which any tax which has become payable in respect of the supply to the vendor or the importation by the vendor, as the case may be, of such goods or services or in respect of such goods under section 7 (3) or any amount determined in accordance with paragraph (b) or (c) of the definition of “input tax” in section 1, is input tax, shall be an amount which bears to the full amount of such tax or amount, as the case may be, the same ratio (as determined by the Commissioner in accordance with a ruling as contemplated in Chapter 7 of the Tax Administration Act or section 41B) as the intended use of such goods or services in the course of making taxable supplies bears to the total intended use of such goods or services: Provided that—

- (i) where the intended use of goods or services in the course of making taxable supplies is equal to not less than 95 per cent of the total intended use of such goods or services, the goods or services concerned may for the purposes of this Act be regarded as having been acquired wholly for the purpose of making taxable supplies; ...*

Section 17(1) explicitly requires that a ratio must be used to calculate the input tax that a taxpayer is allowed to claim in respect of making taxable supplies. However, the VAT Act does not prescribe a ratio to be used by taxpayers in making this apportionment. SARS consequently issued a Binding General Ruling (BGR 16) to assist taxpayers in making the necessary apportionment by prescribing a specific method that vendors should use to determine the ratio mentioned in section 17(1) of the VAT Act. A Binding General Ruling is defined in the Tax Administration Act 28 of 2011 as a written statement issued by a senior SARS official to clarify the Commissioner’s application or interpretation of the tax law on matters of general interest or significance.

The ratio prescribed in BGR 16 is also known as the standard turnover-based (STB) method and is the only pre-approved VAT apportionment method available to a taxpayer (Jembula, 2020). According to SARS (2022a:65) the above-mentioned method must be applied in the instance that a vendor did not obtain a ruling to use an alternative method of apportionment. Alternative methods include, amongst others, methods based on inputs, floor space, transaction count and employee time spent (Jembula, 2020:2).

The STB apportionment ratio is calculated by applying the total value of consideration for taxable supplies to the total value of consideration for all supplies, including any other amounts which were received during the VAT period whether in respect of a supply or not. Therefore, the total

supplies (denominator) include amounts that are generally not the result of any ongoing effort by a vendor, such as dividend income, interest income, and realised gains on exchange transactions (Ernst & Young, 2011).

BGR 16 further requires that a VAT vendor may only apply the above-mentioned ratio to its mixed purpose supplies if the method is a fair and reasonable reflection of the taxpayer's VAT application (SARS, 2015:2). In instances where the standard turnover-based method fails to provide a reasonable estimate of the degree of taxable application of the enterprise's VAT inclusive expenditure, the vendor can apply to SARS for an alternative, more appropriate method of apportionment. However, these methods are predominantly granted with prospective effect which may seem counter-intuitive and inequitable (Jembula, 2020).

Badenhorst (2019) claims that "a turnover-based method such as the STB method as prescribed by BGR 16 will only yield a fair and reasonable result if there is a constant relationship between every output transaction (taxable or exempt) and the VAT incurred on expenses". The turnover-based method accepts the profit margin of taxable and exempt transactions to be similar, while in practice it may vary significantly. Moreover, the ratio requires the inclusion of all interest and dividends received by the taxpayer in the denominator of the formula. However, no direct or indirect taxable expenditure are necessarily incurred to produce dividends or interest on excess funds in a bank account. Consequently, interest and dividends are incorporated into the formula on the assumption that resources are used to produce dividends and interest in the same way as producing taxable supplies, thereby distorting the accuracy of the ratio (Badenhorst, 2021). Marais (2014:52) shares a similar view and concludes that this distortion will result in vendors applying for alternative apportionment methods since the ratio will not necessarily be a fair and reasonable reflection of the vendors' tax application.

Taxpayers who fail to apply for an alternative apportionment ratio timeously, or who fail to apply for the renewal of their previously approved but now expired ratio within the allowed time frame, are forced to apply the STB method for the entire year of assessment due to proviso (iii) to section 17(1) which prohibits retrospective application. This proviso states that:

where a method for determining the ratio referred to in this subsection has been approved by the Commissioner, that method may only be changed with effect from a future tax period, or from such other date as the Commissioner may consider equitable and such other date must fall—

(aa) in the case of a vendor who is a taxpayer as defined in section 1 of the Income Tax Act, within the year of assessment as defined in that Act, or

(bb) in the case of a vendor who is not a taxpayer as defined in section 1 of the Income Tax Act, within the period of twelve months ending on the last day of February, or if such vendor draws up annual financial statements in respect of a year ending other than on the last day of February, within that year,

during which the application for the aforementioned method was made by the vendor.

As a result, the taxpayer may be deprived of significant input tax deductions. Such prevention is in contradiction with the context and strategy of the VAT system which permits an input tax deduction to the extent of making taxable supplies (Badenhorst, 2021).

The Value-Added Tax Guide for Vendors (hereafter referred to as the VAT 404 guide for vendors) (SARS, 2022a:65) requires vendors applying the STB method of apportionment, as set out in BGR 16, to be objective in utilising this method and to ensure that the result is fair and reasonable from the Commissioner's perception as well. This is important since vendors that uses the STB method to their advantage i.e., to claim higher amounts of input tax than what is fair and reasonable, are also a concern as this puts SARS at a disadvantage. Therefore, in determining whether the STB method is suitable, the vendor must apply a common-sense approach which would be applied by a reasonable person. In instances where the STB method is not regarded to be fair and reasonable from the Commissioner's perspective, SARS is allowed to prescribe a different method of apportionment to taxpayers which more accurately reflects their tax application. However, in instances where the alternative method is in favour of SARS, SARS is prohibited from approving retrospective application by virtue of proviso (iii) to section 17(1) (Badenhorst, 2021).

The application of a fair and reasonable apportionment ratio by taxpayers is crucial to SARS, as proven by a study showing that VAT constituted the second-highest share of tax revenue in 2019. According to the study, VAT represented 24% of the total tax revenue received by SARS in that year (OECD, 2021). In 1999, SARS issued an Explanatory Memorandum on the Revenue Laws Amendment Bill which provided for the 5% increase of the *de minimis* rule percentage. This Explanatory Memorandum stated that "although the 90 per cent use for making taxable supplies appears to be high, substantial amounts of VAT are lost as a result of this concession. The proviso is accordingly amended to increase the percentage to 95 per cent" (SARS, 1999:40). This amendment was implemented by SARS to protect the VAT system against unreasonable or even unlawful apportionment ratios being applied by taxpayers, thereby ensuring that SARS does not forego substantial amounts of revenue in the form of input tax deductions claimed by taxpayers. The importance of taxpayers accurately apportioning their input tax is further emphasised by the

measures implemented by SARS if a taxpayer does not adhere to the apportionment rules. If VAT is not apportioned where apportionment is necessary, a non-disclosed liability to SARS will arise for the overstatement of VAT input (Jembula, 2020:4). This overstatement will result in an administrative non-compliance penalty equal to 10%, plus an understatement penalty which can rise up to 200% of the non-disclosed liability (*Tax Administration Act 28 of 2011*). In addition to these penalties, SARS will levy interest on the amount owed to them at the applicable rate and may even pursue criminal prosecution for a tax offence. It is therefore clear that accurate apportionment of input tax is crucial to SARS in order to protect the VAT system.

The *Mukuru Africa (Pty) Ltd v Commissioner for the South African Revenue Service* (2021) case illustrates the controversy caused by the current apportionment approval system. The outcome of this case meant the taxpayer lost substantial amounts of input tax deductions due to SARS refusing the retrospective application of a transaction count-based method to apportion inputs, thereby forcing Mukuru Africa (Pty) Ltd to apply the standard turnover-based method for their 2014 to 2016 years of assessment, even though it was not a fair and reasonable approach. SARS, the Tax Court, and the Supreme Court of Appeal agreed that proviso (iii) to section 17(1) of the VAT Act precluded the Commissioner to allow the retrospective application of the alternative apportionment method.

Consequently, a comparative study to benchmark the current approach and identify alternative mechanisms to balance the interests of taxpayers and the fiscus could be highly valuable.

Taxes, which are similar to VAT, are implemented in both New Zealand and Australia, namely goods and services tax (GST), which also has the purpose of taxing the consumption of goods and services in the economy. Like South Africa, the New Zealand and Australian governments apply the fair and reasonable principle to the amount of GST credits that may be claimed by taxpayers on making taxable supplies.

However, the Australian GST law does not prescribe any specific method of apportionment (ATO, 2023c). Instead, the Australian Taxation Office (ATO) advises taxpayers to apply any method that will result in them claiming a fair and reasonable amount of GST credits. In order to assist taxpayers in calculating the correct amount of GST credits claimable, the ATO provides general guidelines on how to identify and choose a fair and reasonable methodology (ATO, 2023c). Taxpayers are consequently required to maintain all documents to support their decisions should an enquiry or dispute be made by the ATO.

New Zealand's tax authority, the Inland Revenue Department (IRD), follows a different approach. In terms of New Zealand's GST law, "the estimated intended taxable use of the goods or services

will determine the proportion of the input tax that can be deducted" (IRD, 2010). A purchaser will be able to deduct input tax on the acquisition of goods and services to the extent it is used for making taxable supplies. To determine the extent of taxable supplies, the purchaser must estimate, on the date of purchase, how they intend to use the item and choose an apportionment method that will provide a fair and reasonable result. Should the intention subsequently change, the taxpayer is required to make either an input or output tax adjustment depending on the change of intention. A recent amendment to the GST Act allows taxpayers to choose an apportionment method from a variety of methods published by the IRD that is considered appropriate for specific industries.

Due to the similar objectives but different apportionment approaches of the VAT Act of South Africa and the GST Acts of New Zealand and Australia, respectively, it can be valuable to consider these countries' methods of apportionment, particularly as it relates to the approval of these apportionment methods.

1.2 Problem statement and research question

The standard turnover-based method, which is the only pre-approved method, does not seem to yield a fair reflection of the tax application of all entities, as is required by SARS. However, alternative methods are granted with prospective effect which may seem counter-intuitive and unjust. The pre-approved method is set out in a publication issued by SARS, i.e., BGR 16 (2015), with no apportionment provision contained in section 17(1) of the VAT Act. Consequently, this results in some taxpayers having to apply inappropriate apportionment methods which is not reflective of their tax application until such time that they apply and get approval for an alternative method. The VAT apportionment approval mechanism is therefore considered to be contentious and impractical for these taxpayers. This issue highlights the necessity to consider alternative methods, or elements of alternative methods, which may strike a more equitable balance between the interests of taxpayers and the fiscus. As a result, the following question arises:

Are there alternative VAT apportionment approval methods implemented in other countries that can potentially be considered in South Africa?

1.3 Research objectives

1.3.1 Primary objective

The primary objective of this study is to critically compare the VAT apportionment method and basis of approval of South Africa, as contained in BGR 16, with that of other countries by considering the legislation, publications, and rulings of the different tax systems. This comparison

is conducted in order to identify possible alternative approval methods, or elements thereof, that can be implemented in South Africa in order to yield a more equitable balance between the interests of taxpayers and the fiscus.

1.3.2 Secondary objectives

- To conduct an analysis of the principles of a good tax system, specifically focussing on neutrality, clarity and simplicity, fairness and equity, transparency and administrative ease. This is a theoretical objective that is addressed in Chapter 2.
- To conduct an analysis of South Africa's legislation and rulings which are relevant to VAT apportionment. This is a theoretical objective that is addressed in Chapter 3.
- To compare the goods and services tax systems of Australia and New Zealand with that of South Africa to evaluate it in terms of the principles of a good tax system. This is a theoretical objective that is addressed in Chapter 4 and Chapter 5.

1.4 Research design and methodology

1.4.1 Paradigmatic assumptions

Interpretivism is a sociological research method in which an event is analysed based on the beliefs, norms, and values of the culture of the society in which it takes place. It is a qualitative method used to study data related to human actions in sociology (Hepler, 2022). Interpretivism originates from hermeneutics, which can be described as the theory and methodology of interpretation (Dyer, 2010). The interpretivist paradigm believes that reality is multi-layered, intricate and that a single phenomenon can have numerous interpretations (Intgrty, 2016). The aforementioned paradigm stands in direct contrast to the positivism paradigm. The positivist paradigm assumes that a single tangible reality exists. A reality that can be comprehended, acknowledged, and measured (Park *et al.*, 2020:691). Park *et al.* (2020:692) further explain that a positivist study usually focusses on finding explanatory connotations or casual relationships through quantitative methodologies in which empirically based results are favoured.

This study follows an interpretivist paradigm since the objective of the study is to compare the VAT apportionment approval method of South Africa with the approval methods of Australia and New Zealand, in an attempt to identify possible alternative methods that can be implemented in order to yield a more uncontroversial and practical result. Therefore, the aim of this research is to gain an understanding of the aforementioned countries' legislation, interpretation notes or similar documentation in order to make a comparison rather than to prove a single reality.

The interpretivist paradigm is further influenced by ontological and epistemological assumptions. Ontology is defined as “a branch of philosophy that is concerned with the nature of what exists” (Bryman *et al.*, 2004). It is the study of theories of existence and what makes up reality. In contrast, epistemology is the “study of knowledge” (Truncellito, s.a.). This assumption is concerned with the aspects of legitimacy, scope, and the methods of obtaining knowledge (Blackman & Moon, 2017).

1.4.2 Research methodologies

Research methodologies are the plans and procedures that convert general assumptions to detailed methods of data collection and analysis (Creswell, 2009). Quantitative research is described by Creswell (2009) as the process of “collecting, analyzing, interpreting and writing the results of a study”. In this type of methodology, objective theories are tested by investigating the relationship between a set of variables. In contrast to this, qualitative research involves the collection and analysis of non-numerical data in order to understand theories, beliefs, and experiences (Bhandari, 2020). Furthermore, qualitative research strives to embrace the contextual influences on the research matters by examining individuals in their natural setting in order to identify how their behaviour is influenced by the context of their lives (Bailey *et al.*, 2020).

In this study a qualitative research methodology is used in order to address the objectives of this study since a critical comparison between the VAT apportionment methods of South Africa, Australia and New Zealand is performed, as well as an analysis of the legislation and interpretation notes relating to the apportionment methods of the respective countries. This involves obtaining and analysing the legislation and interpretation notes of the respective countries. The aforementioned constitute non-numerical data, thereby motivating the fact that this study applies a qualitative research methodology. Furthermore, this study follows an interpretivist paradigm. According to Bailey *et al.* (2020) the qualitative research methodology is guided by the concepts of an interpretivist paradigm, while quantitative research is steered in accordance with assumptions relating to the positivist paradigm.

1.4.3 Research method

In order to address the primary objective of this study, a comparison between the VAT apportionment approval methods as applied by the tax authorities of South Arica, Australia and New Zealand is performed. This comparison aims to determine the most practical and uncontentious manner in which approval for an apportionment ratio can be provided. This is achieved by conducting a document analysis of the respective countries’ legislation and publications issued by the relevant tax authorities to obtain an in-depth understanding of the

implemented approval procedures and the rationale behind them. A document analysis is a research method that uses systematic techniques to analyse documentary proof and answer questions relating to the research subject (Frey, 2018). Moreover, the analysis specifically focusses on the scope and timing of the approval methods. As previously discussed, South Africa has a single pre-approved method i.e., the standard turnover-based method and any taxpayer who can prove that this method is not a true reflection of the tax application by that taxpayer, has to apply to the Commissioner for approval to use a different method which is applied with prospective effect. Consequently, disputes arose due to taxpayers being forced to apply improper apportioning ratios and therefore the viability of each country's specific approval method is considered. The comparison aims at identifying possible shortcomings in South Africa's approval methodology when compared to that of Australia and New Zealand.

In order to appropriately compare the VAT apportionment approval methods of the respective countries it is necessary to have a comprehensive understanding and knowledge of the relevant sections of the VAT Act, specifically section 17(1), as well as the binding general rulings governing South Africa's approval methodology, as issued by SARS. The implementation of and amendments to section 17(1) and BGR 16 are thoroughly examined together with the rationale behind it. Literature studies of previous research which is relevant to this study are also used in order to broaden the understanding of the apportionment methodology and the issues thereof.

Lastly, alternative methods of apportionment approval and the applicability thereof in South Africa are considered in order to address the overall objective of this research. These alternatives were determined after the comparative analysis has been completed and appropriate methods have been identified.

1.4.4 Rationale for choosing Australia and New Zealand as comparative countries

South Africa's VAT system, as set out in the VAT Act, is rooted in New Zealand's *Goods and Services Tax Act 141 of 1985* (Janse van Rensburg, 2011:17). GST was implemented in New Zealand on 1 October 1986 at a rate of 10% (Janse van Rensburg, 2011:42). Less than five years later South Africa introduced the same consumption tax based on New Zealand's system. The fact that South Africa's VAT system originates from New Zealand makes it an appropriate country for comparative analyses. Additionally, amendments have recently been made to New Zealand's *Goods and Services Tax Act 141 of 1985*, specifically regarding GST apportionment, thereby making it a good country for comparison since the changes can be followed effortlessly.

VAT was implemented in South Africa on 29 September 1991 while this consumption tax was only introduced in Australia nine years later on 1 July 2000. The Australian Taxation Office (ATO)

originates from the *Land Tax Act* of 1910 and is now formally established under the Australian Tax Administration Act of 1953. SARS on the other hand, has a much shorter history as it was originally established under the South African Revenue Service Act 34 of 1997 and currently falls within the ambit of the South African Tax Administration Act 28 of 2011. Despite the significant time lapse in GST implementation, these two countries' legislation are quite similar. Both South Africa's VAT system and Australia's GST system are based on the destination principle, use the invoice credit method, and have low registration thresholds. Lastly, both the South African and Australian consumption tax is based on New Zealand's *Goods and Services Tax Act* 141 of 1985. Therefore, the historic diversity and legislation similarities of these two countries provide a compelling case for comparative analyses to South Africa (Datt *et al.*, 2016:3-8).

1.5 Ethical considerations

In conducting this study, the relevant legislation, publications, and other appropriate sources are consulted, and a detailed literature review is performed in order to gain knowledge of prior research relevant to this research area. These sources have been appropriately referenced in order to give recognition to those individuals or organisations by whom the work has been performed and to avoid any ethical concerns. There is thus minimal risk since human participation is not a factor.

1.6 Chapter overview

1.6.1 Chapter 1

The first chapter consists of the background to the research topic, namely VAT apportionment approval methodology. This chapter sets out the basic information of the legislation and SARS publications that govern VAT apportionment approval for taxpayers. Furthermore, this chapter emphasises the appropriateness of the topic through a discussion of recent issues and opinions. Additionally, this chapter specifies the problems with regard to the current approval methods in South Africa and outlines the objectives that this study aims to achieve.

1.6.2 Chapter 2

In this chapter the fundamental principles of a value-added tax system are discussed to give a proper background on the rationale of this tax system and the importance thereof to the fiscus. Thereafter, the principles of a good tax system, as it relates to value-added taxes, are discussed. This chapter allows for an appropriate comparison between the VAT system of South Africa and

the GST systems of Australia and New Zealand, respectively, with specific focus on the apportionment approval methodology. This comparison is made in Chapter 4 and Chapter 5.

1.6.3 Chapter 3

In this chapter a detailed analysis of the South African legislation and publications governing VAT approval methodology is performed. This analysis focusses on the origin of the specific legislation, the motivation thereof, as well as various components of the tax system. Furthermore, a literature review is performed to gain insight into past research conducted in this area to gain a better understanding of the issue at hand. Lastly, a discussion on recent case law related to the subject matter is presented.

1.6.4 Chapter 4

This chapter provides a detailed analysis of the GST system implemented in Australia. Thereafter, a comparative analysis between the tax systems implemented in South Africa and Australia is made by considering the principles of a good tax system, specifically focussing on the approval methodology. This, together with the detailed analysis of South Africa's VAT system as set out in Chapter 3, assists in identifying possible alternative methods that can be implemented in South Africa to replace the current approval system by considering the methods implemented in Australia.

1.6.5 Chapter 5

Similar to Chapter 4, this chapter consists of a detailed analysis of the GST system implemented in New Zealand. Subsequently, a comparative analysis between the tax systems implemented in South Africa and New Zealand is made, taking into consideration the principles of a good tax system as discussed in Chapter 2. This, together with the detailed analysis of South Africa's VAT system as conducted in Chapter 3, aids in identifying possible alternative methods that can be implemented in South Africa to replace the current approval system by considering the methods implemented in New Zealand.

1.6.6 Chapter 6

In this final chapter, an overarching conclusion is drawn from the research conducted throughout this study in order to address the objectives described in Chapter 1. Furthermore, a conclusion is made regarding whether there is an alternative approval method that can be utilised for VAT apportionment in South Africa which is more practical and uncontentious.

2 Chapter 2 The fundamentals of a value-added tax and the principles of a good tax system

In this chapter, the fundamentals of a value-added tax system are discussed in order to form the basis of the comparisons to follow in Chapter 4 and Chapter 5. The focus is on the foundation of this tax system and the importance thereof to the fiscus. Additionally, the principles of a good tax system are discussed with a specific focus on VAT in order to appropriately compare the VAT systems of South Africa, Australia, and New Zealand. It should be noted that the goods and services tax implemented in Australia and New Zealand is essentially also a value-added tax and therefore the discussion below is also applicable to the GST system.

2.1 Fundamentals of a value-added tax

Consumption tax refers to tax imposed on the acquisition of goods or services that is paid indirectly by the consumer in the form of either retail sales tax, excise tax, value-added tax or goods and services tax (GST) and collected from enterprises operating in the production and distribution chain. The tax is indirectly imposed on certain acquisitions which is financed by income and wealth, rather than the imposition of tax on the income or wealth itself (OECD, 2022a). Consequently, a person's spending, rather than earnings is taxed, thereby ensuring neutrality with respect to current and future income. Theoretically, the term VAT (used synonymously with GST) is a tax on the difference between the cost to the producer for raw materials and labour and what the producer charges for the final good or service (Ehrbar, 2008). Accordingly, the term value-added originates from this principle.

The predominant purpose of a general consumption tax such as VAT or GST is to levy a broad-based tax on final consumption by households. In essence, only private individuals, as opposed to businesses, participate in the consumption at which a VAT is targeted (OECD, 2022a). Since the purpose of VAT or GST is to tax the final consumption of goods and services by households, the tax is collected in a staged process. Under this principle the tax is collected from enterprises only on the value added at each stage of production and distribution. Therefore, in order to satisfy the purpose of taxing only the final consumption, businesses are allowed to claim back the VAT imposed on its taxed inputs by offsetting the inputs from its output tax (OECD, 2022a). However, when businesses acquire goods or services only partially for making taxable supplies, and partially for making non-taxable or exempt supplies, the business will not be allowed to claim input tax to the extent that the goods or services are used for making non-taxable or exempt supplies (SARS, 2022a:57). This is because the business will not levy output tax on these goods or services and is therefore regarded as the final consumer.

Value-added taxes are an economically effective way of raising tax revenue and has become one of the most important revenue sources for many countries. In comparison to other tax revenue sources, consumption tax revenue as a share of GDP tends to be fairly stable over a period of time, even during economic declines (Tax Foundation, s.a.).

2.2 Principles of a good tax system

The imposition of tax is a concept that dates back as far as recorded history when the Pharaoh of Ancient Egypt instructed his chief minister to organise thousands of scribes to collect taxes from all the kingdom's citizens (Blankson, 2007:3). Egypt was without coined money at the time and grain signified a tangible store of value that could effortlessly be collected, traded, and redistributed. Since then, the taxation system has become much more advanced and represents one of the most important revenue streams for governments all over the world (Ortiz-Ospina & Roser, 2016). According to the Organisation for Economic Co-Operation and Development (OECD) (2014:30) the primary purpose of tax is the raising of revenue to finance public goods and services such as municipal infrastructure and the enforcement of law and order. Consequently, the level of revenue required to be raised in each country has a direct influence on the tax policy followed in that specific country as well as the development of that country's tax system. The term tax policy refers to the guidelines, decisions, and principles established by a government that determines the characteristics of a tax system and make it possible to finance public spending and support economic activity in the relevant country (Cliche, 2012:1). As claimed by the OECD (2014:30) there are various tax policy considerations that guide the development of taxation systems. The most pertinent considerations include principles such as neutrality, certainty and simplicity, fairness and equity, transparency, and administrative ease. These are also known as the principles of a good tax system and can be used to compare tax systems in different jurisdictions. According to the International Chamber of Commerce (ICC) (2019) an efficient VAT regime ensures certainty, neutrality, simplicity, and cost-effectiveness for both businesses and tax administrations.

Another principle that also forms part of the building blocks of a sound tax system is adequacy (ITEP, 2012). Adequacy means that the tax must raise enough funds to satisfy the basic needs of society. This principle is not central to the issue of VAT apportionment and therefore irrelevant when comparing the VAT systems of South Africa, Australia, and New Zealand. As a result, only the first mentioned principles are discussed.

2.2.1 Neutrality

A neutral tax can be described as one that does not create incentives for companies or individuals to alter their behaviour e.g., to increase or decrease investments, to work more or less, or to locate in one place instead of another. Chen (2018:33) describes tax neutrality as “a tax system not influencing the taxpayers’ business decisions”. Essentially, a neutral tax system will exercise minimal impact on both the spending and business decisions made by companies and individuals and therefore aims to raise revenue in a manner that minimizes discrimination against a specific economic choice. As a result, identical taxation principles should be applied to all forms of business, while simultaneously confronting attributes that may challenge neutrality in the system. In addition, tax neutrality also assists the fiscus in ensuring that the correct amounts of tax revenue are collected (OECD, 2017a).

Neutrality in terms of VAT consists of various dimensions, including the absenteeism of discrimination in a tax setting. This concept aims to create an environment that is unprejudiced and that eliminates unjustifiable tax burdens and compliance costs for businesses (OECD, 2017a). As mentioned, VAT is a consumption tax and therefore it should not impede companies providing goods or services to customers i.e., it should be neutral for these entities. This principle is executed by ensuring a deduction of the VAT paid, on the acquisition of goods and services used for business purposes, from the VAT levied on the supply of goods or services. The right to an input tax deduction constitutes a fundamental part of the VAT mechanism and intends to free the vendor completely from the VAT liability incurred on the acquisition of goods and services procured within the context of business activity, irrespective of its purpose and results, provided that such business activity is subject to VAT itself (Famulska & Rogowska-Rajda, 2018:88). In this way the consumer bears the ultimate liability of VAT rather than the intermediaries in the supply chain (Famulska & Rogowska-Rajda, 2018:88).

In local trade, neutrality is accomplished by the staged collection process, whereby tax is only imposed on the value added by businesses at each stage of the production and distribution supply chain. In this process, each business in the supply chain pays VAT to its suppliers on the inputs acquired and collects VAT from clients on the supplies made to them. The input VAT is set off against the output VAT so that the correct amount of tax remitted to the fiscus is the net amount of the two. This results in the VAT flowing through the business to tax the final consumer. The complete right to subtract input tax from output tax throughout the supply chain, apart from the final consumer, ensures the neutrality of the tax, irrespective of the nature of the product, the structure of the supply chain, and the resources used for its distribution (OECD, 2022a). To ensure that the burden does not rest with the intermediaries in the supply chain, it is crucial that

the supplier is allowed a full input tax deduction at each stage (provided it is used wholly for making taxable supplies), thereby guaranteeing that VAT is taxed on consumption (OECD, 2011:6).

Furthermore, the right to subtract input tax from output tax prevents a cascading effect from occurring in the VAT system. A cascading effect occurs when a tax is levied on goods or services at each stage in the supply chain with no deduction for taxes paid in earlier stages (Habiger, 2023). Consequently, the tax that is levied on the value includes the tax that was paid in the previous stage and therefore results in a higher tax burden for final consumers. This principle discourages economic activity and is prevented by allowing suppliers in the supply chain to offset the tax incurred to make taxable supplies from their ultimate output tax liability.

Non-neutralities in a tax system can lead to the distortion of taxpayers' decisions, merely because of economic reasons. Furman (2008:2) is of the opinion that, in addition to distorting decisions, non-neutral tax systems lead both companies and individuals to bestow socially wasteful efforts in restructuring the form or substance of their activities in an attempt to reduce their tax liability. Such efforts include hiring lawyers or tax practitioners to structure their financial activities in such a way that it decreases their tax payable. Nevertheless, it should be kept in mind that some non-neutralities are inevitable. One of these unavoidable non-neutralities includes the fact that the market consumption of goods and services will be taxed, either directly through VAT (or GST), or indirectly through personal income taxes. It is however widely accepted that tax payments should escalate with some form of well-being (Furman, 2008:2).

According to Furman (2008:3) there are a few tax policy considerations that can be implemented that will result in a more neutral tax system. For value-added tax systems, the primary consideration is about broadening the tax base while lowering the tax rate. Furman (2008:3) further states that a higher level of neutrality is achieved when the tax base is broadened since more items will be taxable, thereby reducing discrimination against specific economic choices. Moreover, a lower tax rate will lead to a more neutral tax code regarding a person's employment status. DeMarco (2022) claims that a narrow tax base is non-neutral and inefficient, while a broader tax base allows for higher revenue collection at a lower rate. Furthermore, fewer exclusions may reduce compliance costs for taxpayers tracking tax-preferred activities since it will lessen the time required to understand the qualifying and reporting requirements and the time required to complete tax returns (OECD, 2010:15). The OECD (2010:15) further states that a less complex tax system (achieved by broadening the tax base) can lead to a higher level of taxpayer compliance, which in turn enables a reduced tax rate when considering a specific revenue prerequisite.

VAT is a destination-based tax and consequently international trade will also conform to tax neutrality as a result of the destination principle. This principle intends to ensure that taxation arises in the country of consumption, and therefore provides for the zero-rating or exemption of exports, while importations are subject to VAT. As a result, the total amount of tax in respect of a supply is determined by applying the rules of the jurisdiction in which consumption takes place. Neutrality is therefore also achieved in the export country, since the supplier is allowed an input tax deduction for the VAT paid on the supplies being exported. This ensures that the input or output VAT chain remains intact, and that VAT does not impact the competitiveness of local businesses to export. Furthermore, it ensures that there remains a single place of taxation and that all income eventually accrues to the country where the supply to the final consumer arises (Charlet & Buydens, 2011:444-445). The OECD (2011:5) illuminates the tax neutrality principle relating to international trade by stating that “as a neutral tax the total amount of VAT collected should not be influenced by the economic or geographical structure of the value chain”. This statement emphasises the fact that the place of consumption will determine the jurisdiction to which VAT revenue will accrue.

The OECD, however, raised neutrality concerns with regard to the difficulties of businesses recovering VAT incurred in jurisdictions for which they are not obliged to register for VAT (Charlet & Buydens, 2011:443-444). According to a survey they conducted, businesses suffer great amounts of VAT incurred in foreign countries as a result of major compliance burdens, despite procedures implemented by that specific foreign country to relieve these businesses from local VAT (Charlet & Buydens, 2011:443). Most businesses attribute these compliance burdens to insufficient communication with the foreign countries’ authorities (including guidance, forms, and procedures) as well as the repayment delays, resulting in this business to outsource their foreign VAT recovery (Charlet & Buydens, 2011:444). Accordingly, the OECD has set out guidelines to encourage jurisdictions to ensure that foreign companies do not incur irrecoverable VAT.

Guideline 2.4 of the International VAT/GST Guidelines states that “with respect to the level of taxation, foreign businesses should not be disadvantaged or advantaged compared to domestic businesses in the jurisdiction where the tax may be due or paid” (OECD, 2017b:32). This guideline stresses the fact that:

- *there should be no discriminatory application of the rules merely for the reason that a business is foreign;*
- *foreign businesses should not end up having a tax advantage compared to local businesses in terms of their final tax burden, and*
- *if Guideline 2.4 is followed, VAT should not distort competition between*

foreign and domestic businesses.

Furthermore, guideline 2.5 of the International VAT/GST Guidelines sets out that “to ensure foreign businesses do not incur irrecoverable VAT, jurisdictions may choose from a number of approaches” (OECD, 2017b:33). These include (but are not limited to):

- *making supplies free of VAT;*
- *allowing foreign businesses to obtain a refund through a specific regime;*
- *allowing foreign businesses to obtain a refund through local VAT registration;*
- *shifting the responsibility to locally registered suppliers/customers, and*
- *granting purchase exemption certificates (OECD, 2017b:33).*

Jurisdictions can also elect to use a combination of the above-mentioned methods, depending on the nature of the supplies. However, the primary purpose of guideline 2.5 is to ensure that foreign companies avoid suffering irrecoverable VAT.

VAT neutrality therefore ensures that it is the consumer who bears the cost of VAT. Whether a business increases their prices to include VAT or whether their business revenue is reduced due to their output tax liability, it will be the consumer that is affected by the tax, either due to a decline in disposable income because of increased prices, or due to a decline in nominal income as a result of lower profits distributed to employees and investors (Tax Policy Centre, 2020).

The OECD (2011:4) emphasises the fact that business decisions should be based on economic considerations rather than tax considerations by stating that businesses should not be burdened with inappropriate compliance costs that can possibly manipulate their economic decisions. In addition, the VAT system should not discriminate against similar businesses with similar transactions but should ensure that they are taxed in an equal manner.

2.2.2 Certainty and simplicity

This principle implies that taxation rules should be clear and relatively easy to comprehend. When regulations for a specific tax are simple, taxpayers who have to apply the rules can more easily understand their rights and responsibilities and can therefore be expected to make better decisions and respond to intended policy choices (OECD, 2014:13). The Association of Chartered Certified Accountants (ACCA) (2020:5) is of the opinion that certainty is a key requirement for the appropriate operation of a good tax system and that this is an aspect where many jurisdictions fail. Certain tax application is pivotal in the decision-making process of businesses since decisions based on inadequate assumptions pose a significant risk to businesses. According to businesses,

uncertainty in a value-added tax system is considered relevant for investment and location decisions (European Commission, 2017:3).

The most uncertainties in the tax system are internally generated and occur whenever the calculation of a tax liability is influenced by a subjective condition (ACCA, 2020:8). Although conciseness in tax law contributes to the simplicity thereof, uncertainty can easily arise due to subjective interpretations being made in the absence of detailed definitions. In contrast, tax law can become highly complicated when the law is extremely detailed, resulting in taxpayers incurring additional costs for tax advice on the provisions of the act. Policymakers should therefore keep in mind the balance between certainty and simplicity whenever designing or amending a tax system. The interests of large businesses are better served by certainty, while individual taxpayers will prefer a simpler tax system. When considering a consumption tax system, and its high registration threshold, the tax system may lean towards being more certain than simple.

As mentioned above, uncertainty can arise when the calculation of a tax liability is influenced by subjective conditions. When considering the value-added tax system and the apportionment of input tax, it should be noted that subjectivity plays a major role in determining the portion of input tax credits claimable by a taxpayer where goods or services were acquired for both taxable and non-taxable purposes. This is because the taxpayer must apply a percentage to the total amount of VAT incurred on the acquisition of goods or services that represents taxable use in order to determine the amount deductible from the output tax liability. Taxpayers are often uncertain as to which amounts to include as part of their calculation. For example, under the South African VAT system dividends and passive interest are included in the denominator of the standard apportionment formula used to calculate input tax. The inclusion of dividend income in the standard turnover-based method prescribed by SARS contradicts several European Court of Justice judgments whereby it was concluded that dividends received by a vendor must be excluded from a turnover-based apportionment method since a shareholder does not incur any taxable resources to generate dividend income (Chitando, 2018:29). Consequently, uncertainty arises amongst taxpayers as to whether it is equitable to include these income streams in the apportionment formula and whether they should apply for alternative methods.

The South African, Australian and New Zealand VAT (or GST) systems require taxpayers to use a fair and reasonable method to apportion income tax. The apportionment method should aim to be objective to obtain a fair and reasonable result from both the taxpayer and the Commissioner's perspective (Jembula, 2020:3). However, fair and reasonable is a highly subjective concept and the perception of what is fair and reasonable to the taxpayer may not be regarded as such by the

tax authority. As a result, uncertainty can arise as to what will be regarded as being equitable from both the taxpayer and the Commissioner's point of view.

2.2.3 Fairness and equity

For a taxation system to be regarded as fair, the system should produce the correct amount of tax at the correct time, while simultaneously preventing double taxation or tax avoidance. Furthermore, the possibility of tax evasion or tax avoidance should be minimized (OECD, 2014:13). Another vital aspect is that the taxation system must be equitable to all its citizens and therefore equity in the tax system is equally as important. Tax equity is a measure of the equality of a tax system based on a person's capability to pay and includes both horizontal and vertical equity (Wodicka, 2018).

Kaplow and Musgrave (as cited by McDaniel & Repetti, 1993:607) define horizontal equity as the requirement that "equals be treated alike" while vertical equity requires a suitable pattern of differentiation between unequals. In simpler terms, horizontal equity means that taxpayers with equal income should pay equal taxes, while vertical equity requires that taxpayers' tax liability should fluctuate in proportion to the income they earn. According to McLure and Zodrow (2007:4) a value-added tax system achieves horizontal equity between taxpayers with a given lifetime endowment (in present value terms) irrespective of whether they earn or choose to consume early or later in their lifetime.

Consumption taxes, whether referred to as VAT or GST, usually have a flat rate varying between 10 to 20 percent. Đorđević (2015:38) is of the opinion that this flat rate tax creates a much larger burden for the part of the population with lower incomes, as opposed to those earning higher amounts. Furthermore, she argues that the application of a single rate in consumption tax contradicts the principle of "payment according to economic strength" and consequently leads to unfair treatment of lower earning taxpayers. However, Đorđević (2015:38) acknowledges the fact that principles such as the zero-rating and exemption of certain items, such as necessities, help to make the tax less regressive. It can therefore be argued that the zero-rating and exemption of specific goods and services contribute to making consumption tax fairer to taxpayers.

The purpose of a consumption tax is to tax the goods or services upon consumption by its end user. VAT is a non-cumulative tax, meaning that a credit or deduction is allowed for VAT paid in prior stages, within the production and distribution chain (SARS, 2023a). Consequently, businesses are allowed to claim back the VAT imposed on its taxed inputs by offsetting the inputs from its output tax (OECD, 2022a). The input deduction prevents a cascading effect from occurring since the tax is only levied on the value added in each stage of the supply chain and

therefore reduces the tax burden for consumers. This compliments the fairness principle since double taxation or tax on tax is avoided.

An issue negating the fairness principle relates to the apportionment of input tax credits. A vendor who makes both taxable supplies, and supplies other than taxable supplies, may only claim input tax to the extent that the goods or services concerned are acquired for consumption in making taxable supplies (Ernst & Young, 2011). However, this principle is overridden when vendors are unable to deduct the full amount of tax incurred in making the taxable supply or if taxpayers claim input tax in excess of what they are entitled to. This issue therefore occurs when the input tax credits require apportionment due to the vendor making mixed purpose supplies and is therefore prohibited from claiming the full amount. Under the South African VAT system, the apportionment of such expenditure is calculated by applying a percentage, representing taxable use, to the total amount of VAT incurred. However, this percentage is based on subjective factors and may therefore not be equitable to either the taxpayer or the Commissioner (Jembula, 2020:4). Furthermore, apportionment methodologies provided by tax authorities may also counter the fairness principle if these methods prevent taxpayers from claiming the input tax credits which they are rightfully due. Where a taxpayer or the tax authority is denied the tax which they are rightfully due, as a result of how the tax system is structured, the fairness principle is overridden.

2.2.4 Transparency

Tax transparency is defined by the Global Initiative for Fiscal Transparency (GIFT) (2022:4) as the “disclosure and publication of quantitative and qualitative data about the tax system, that a society needs to hold decision makers to account and to reach informed judgements on how the tax system is performing during a particular time period”. This principle intends to ensure that a tax system operates for the benefit of all stakeholders, both in and out of government. Transparency includes paying the right amount of taxes to the tax authority, thereby enabling the government to finance and deliver national development plans for the benefit of the community (BHP, 2022).

Transparency in a tax system is important as it allows stakeholders, such as tax administrators, government officials, legislators, and those who pay taxes, to:

- Understand how the tax payable is determined;
- Evaluate whether the taxes they are expected to pay are reasonable in comparison to the contribution required by others within their society;
- Recognize how their tax system compares to the tax systems of similar jurisdictions; and
- Know how the taxes that are collected are applied by the government (GIFT, 2022:4).

In a VAT system, VAT vendors have certain obligations to fulfil in order to keep the system transparent. These include:

- The obligation of a business to register as a VAT vendor when turnover exceeds the threshold;
- The responsibility of a VAT vendor to keep accounting records for the prescribed period;
- The responsibility of the VAT vendor to complete and submit VAT returns as per requirement; and
- The responsibility of the VAT vendor to calculate and remit the VAT owing to the Commissioner on or before the due date (Duve, 2016:116).

However, the tax authority also has obligations to keep a tax system transparent. As mentioned, tax transparency should allow stakeholders to understand how the tax is calculated and therefore, the tax authority should be open as to the methods and rationale that is applied to calculate the relevant tax. This is supported by Mercier (s.a.:17) who states that “individuals and business owners should be able to quickly and easily learn about how much officials in each taxing district add to their total tax burden”. Furthermore, stakeholders should be able to determine whether the taxes they pay are fair in comparison to what other stakeholders are paying. Therefore, the methodology applied to different taxpayers should be publicly available.

SARS is of the opinion that a higher level of transparency can lead to a higher level of compliance by taxpayers. SARS (2022b) revealed through a media statement that they believe “the benefits of tax transparency and exchange of information supports the pursuit of developing a Tax and Customs system based on voluntary compliance”.

Consequently, the obligation of keeping taxes transparent falls on both the taxpayer and the tax authority.

2.2.5 Administrative ease

The principle of administrative ease entails that a tax system should not create a substantial cost burden for taxpayers or tax collectors (OECD, 2014:30). The tax should rather be easy and inexpensive to administer. Administrative ease in a tax system can be achieved by ensuring that the rules of the system are understandable and well known by taxpayers. Furthermore, the documentation required by taxpayers should be straightforward and succinct (Oklahoma Policy Institute, s.a.).

Although taxation is currently the only practical way of raising revenue to finance government spending, the tax system should raise the necessary income without unnecessary government borrowing and without discouraging economic activity (Tanzi & Zee, 2001). Tax collection is not an objective of tax policy but simply a requirement and therefore the system should aim to minimize the administrative burden.

According to Neumark and McLure (2023) there are four requirements for efficient tax administration, namely clarity, stability, cost-effectiveness, and convenience. Clarity refers to the fact that tax laws and regulations should be understandable and unambiguous to both taxpayers and tax administrators. Tax laws that are misunderstood cause errors and result in the honesty and respect of the law to be undermined.

The principle of stability requires that the law should not be amended often since frequent changes can lead to reduced compliance. Any amendments to the law should be implemented in the context of a general and systematic tax reform with appropriate provisions for fair and organized transition (Neumark & McLure, 2023).

The third requirement of an efficient administrative tax system, namely cost-effectiveness, entails that the costs of assessing, collecting, and governing taxes should be kept to the lowest level consistent with other goals of taxation. Neumark and McLure (2023) state that the costs to be minimized include those incurred by the government as well as the costs to the taxpayer and of private fiscal agents such as employers, who collect taxes for the government through the withholding procedure. It should be noted that the more complex a tax, the bigger the costs of government administration and the bigger the compliance costs for taxpayers to determine and report their tax liability (AICPA, 2017:7). The simplicity of a tax system therefore has a direct impact on this principle.

Lastly, the payment of taxes should be as convenient as possible to taxpayers. This can be achieved by giving taxpayers sufficient time to submit their tax returns and allowing taxpayers with large tax liabilities to pay in instalments (Neumark & McLure, 2023). The Association of International Certified Professional Accountants (AICPA) (2017:8) stresses the importance of convenient payment policies since it has a direct impact on compliance. The more complicated a tax is to pay, the more likely that payment will not occur.

2.3 Chapter conclusion

General consumption taxes, especially VAT (or GST), contribute largely to the total tax revenue and is consequently an important revenue source for various governments worldwide. In order to

make valuable comparisons between the VAT systems of South Africa and the GST systems of Australia and New Zealand, it is imperative to consider the principles that constitute a good tax system. The principles of neutrality, certainty and simplicity, fairness and equity, transparency, and administrative ease represent crucial elements that should be present in a value-added tax system and are therefore the main focus for comparison. Neutrality supports objectivity in a tax system and is therefore crucial to prevent distorting decisions by taxpayers. Certainty and simplicity in a tax system contribute to taxpayer compliance which is pivotal for a tax system to operate effectively. Furthermore, fairness and equity ensure taxpayer satisfaction and prevent tax avoidance or tax evasion. Lastly, transparency ensures that a tax system operates for the benefit of all stakeholders while administrative ease promotes a tax system that does not create unnecessary tax burdens. Therefore, an analysis of the value-added tax systems of South Africa, Australia and New Zealand is made in Chapter 3, Chapter 4, and Chapter 5 with specific focus on the principles mentioned in this chapter. A comparison is subsequently made between the apportionment systems of the three countries by using these principles as a basis.

3 Chapter 3 Detailed analysis of the South African VAT system

This chapter concentrates on the background of South Africa's VAT system with a focus on how the VAT system has developed over the years and how it currently operates. Thereafter, the importance of VAT revenue to the fiscus is highlighted. Then, the concept of input tax as an element of VAT is discussed. Subsequently, the apportionment of input tax and the approval methodology relating to input tax apportionment are analysed and discussed in detail to get a holistic understanding of the approval methodology followed by the Commissioner. A literature review and case law relevant to VAT apportionment are also considered in the analysis. A detailed study of the input tax apportionment system is necessary to make a useful comparison between South Africa's VAT system and that of New Zealand and Australia in order to determine the possibility of implementing an alternative apportionment approval methodology in South Africa.

3.1 Background and functioning of the South African VAT system

Value-added tax was implemented in South Africa for the first time on 29 September 1991 as a replacement for the one-stage General Sales Tax, also known as GST, which was originally implemented in the country in 1978 at a rate of 4% and increased over time to a rate of 12% in 1985 (National Treasury, 2011). When the Value-Added Tax Act 89 of 1991 (the VAT Act) took effect on 29 September 1991, the rate was originally set at 10% but was subsequently increased to 14% on 7 April 1993 and again to 15% on 1 April 2018. On 12 June 1991, the VAT Act was promulgated, and no provision was made to exclude any goods or services. However, before the introduction of the new VAT Act, the zero-rating of ten basic food items was included. Since then, numerous goods and services have been added to the zero-rating list.

VAT is an indirect tax paid by the consumer in the final stage i.e., when consumed by the taxpayer and is therefore known as a consumption tax. VAT follows the destination principle meaning that the tax is levied on goods or services consumed in South Africa, irrespective of where the goods are produced, or the services are supplied (SARS, 2016:2). The VAT system applies an invoice credit method together with an accrual basis of accounting. The cash basis of accounting may only be used in special circumstances with prior approval from the Commissioner. Due to VAT being a consumption, destination-based tax the exportation of goods and services are zero-rated while imports are subject to VAT. Furthermore, because of practical difficulties South Africa, together with many other countries, exclude non-fee based financial services from the VAT base (National Treasury, 2011). The VAT Act and its provisions are based mainly on New Zealand's *Goods and Services Tax Act 141 of 1985* that originated in 1985 (Datt *et al.*, 2016:6).

A person is obliged to register as a VAT vendor when the total value of taxable supplies for a 12-month period exceeds, or is likely to exceed, R1 million. Alternatively, a person can voluntarily register as a VAT vendor if the total value of taxable supplies for a 12-month period exceeds, or is likely to exceed, R50 000. A further condition for registering is that such person should carry on an enterprise. An enterprise, as defined in section 1(1) of the VAT Act, includes any activity which is carried on continuously by a person in, or partly in, South Africa and in the course of which goods or services are supplied to another person for consideration.

On its initial implementation, questions arose as to whether VAT will be able to replace General Sales Tax (GST) as a revenue source for the fiscus. This indirect tax has played a crucial role in the amount of tax revenue collected by the fiscus since the implementation of GST and is still a critical revenue source for the government as it has been the second most important revenue stream for the fiscus (after personal income tax) since 1985, apart from a single third place ranking in 2009 (National Treasury, 2011). This was confirmed once again in a preliminary revenue outcome announced by SARS for the 2020/2021 year, indicating that VAT revenue constituted 26.5% of the total tax revenue collected by the fiscus for that year amounting to R330.7 billion (SARS, 2021c).

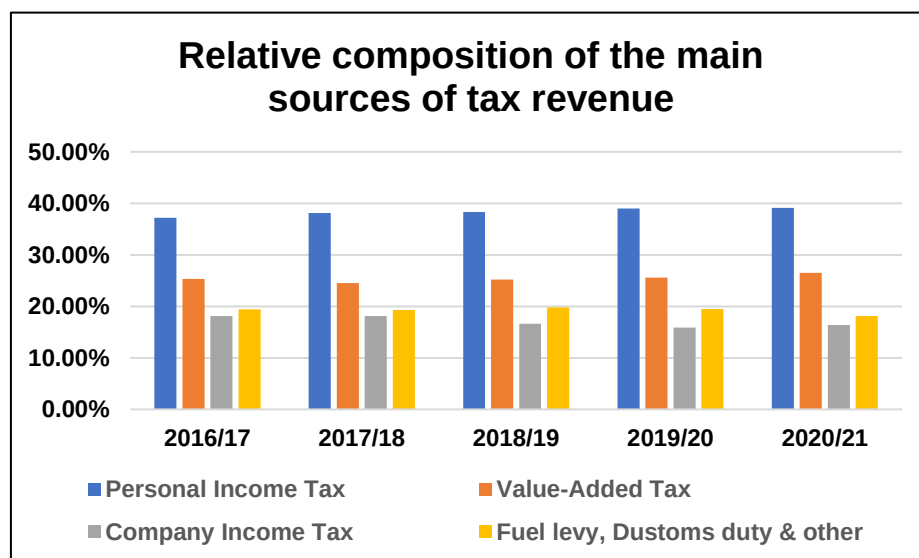


Figure 1: Relative comparison of the main sources of tax revenue

Source: Data obtained from a joint publication between National Treasury and the South African Revenue Service (2022)

Tax revenue refers to the income gained by the fiscus through taxation. Taxation is the primary source of income for the government which is collected by SARS and subsequently handed over to National Treasury. The tax revenue is then distributed to government departments, as well as provincial and local government departments to fund government expenditure (ETU, s.a.:4).

According to Statistics South Africa (2021), the total government expenditure for the 2019/2020 year of assessment amounted to R1.97 trillion of which approximately 60% relates to public services, education, and social protection services. In the same year, the total tax revenue collected by the fiscus was R1 355.8 billion of which VAT represented 25.6% (National Treasury & SARS, 2020:10). The net amount of VAT revenue for the 2019/2020 fiscal year was therefore R346.8 billion. This data illustrates that VAT revenue is a crucial revenue source for the fiscus.

The net VAT income comprises payments by vendors to SARS, refunds to vendors by SARS, as well as import VAT levied on imported goods and services. VAT is levied whenever a vendor sells a good or service which attracts VAT in the course or furtherance of their enterprise. The vendor is then required to pay the amount over to SARS at the end of the relevant VAT period. However, the vendor would have been allowed an input tax deduction on the expenditure incurred to supply the good or service on the condition that the amount has been wholly incurred to make taxable supplies.

3.2 Input tax

Input tax can be described as the VAT incurred on the supply of goods or services to the vendor, VAT incurred on the importation of goods, and, in limited circumstances, VAT on excise duty goods. In addition, the definition includes, *inter alia*, the deemed input tax deduction on the acquisition of certain second-hand goods (Edward Nathan Sonnenbergs, 2012). The term is defined in section 1(1) of the VAT Act while its provisions are set out in section 17 of the VAT Act. The input tax principle allows a vendor to claim back, as a deduction from its output tax liability, the VAT incurred for the purpose of consumption, use or supply, in the course of making taxable supplies. The rationale behind input tax claims can be attributed to one of the fundamental characteristics of this tax, namely VAT neutrality, as discussed in Chapter 2.

Input tax in relation to a vendor as defined in section 1(1) of the VAT Act refers to:

(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; or;

(ii) the vendor on the importation of goods by that vendor; or

(iii) the vendor under the provisions of section 7 (3);

(b) an amount equal to the tax fraction (being the tax fraction applicable at the time the supply is deemed to have taken place) of the lesser of any consideration in money

given by the vendor for or the open market value of the supply (not being a taxable supply) to him by way of a sale on or after the commencement date by a resident of the Republic (other than a person or diplomatic or consular mission of a foreign country established in the Republic that was granted relief, by way of a refund of tax as contemplated in section 68) of any second-hand goods situated in the Republic; and

- (c) an amount equal to the tax fraction of the consideration in money deemed by section 10 (16) to be for the supply (not being a taxable supply) by a debtor to the vendor of goods repossessed under an instalment credit agreement or a surrender of goods: Provided that the tax fraction applicable under this paragraph shall be the tax fraction applicable at the time of supply of the goods to the debtor under such agreement as contemplated in section 9 (3) (c),*

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 provisions of section 17) that the goods or services concerned are acquired by the vendor for such purpose;

The VAT 404 guide for vendors (SARS, 2022a:57) clarifies the requirements for vendors to qualify for an input tax deduction namely:

- the goods or services must be acquired solely or partially for consumption, use or supply in the course of making taxable supplies; and
- the vendor should have been subject to tax at the standard rate on acquisition of the goods or services, apart from the acquisition of second-hand goods or goods repossessed under an instalment credit agreement, which have been acquired in respect of a non-taxable supply; and
- the vendor must be in possession of all the necessary documentation.

In limited circumstances, the VAT Act allows a vendor to claim input tax (known as notional or deemed input tax) on the acquisition of second-hand goods in terms of a non-taxable supply. Consequently, a vendor will be allowed to offset an amount of input tax from their VAT liability when purchasing second-hand goods as defined in section 1(1) of the VAT Act, is situated in South Africa, and acquired from a South African resident, provided it is acquired in terms of a non-taxable supply. Furthermore, the acquisition must be made wholly or partly in the course of

making taxable supplies and the vendor must be in possession of the necessary documentation. Such claim may only be made to the extent that the goods have been paid for.

3.3 Apportionment methodology

As mentioned previously, a vendor is allowed an input tax deduction on any expenditure incurred to supply goods or services that will be used solely to make taxable supplies. Therefore, when determining the amount of input tax that a taxpayer is allowed to claim, the first step is to determine whether the expenditure incurred can be directly attributed to the intended purpose for which the goods or services are used. Direct attribution means that permitted expenditure is incurred either exclusively to make taxable supplies for which input tax can be claimed, or entirely for making non-taxable supplies for which the taxpayer will have no VAT claim (SARS, 2022a:62-63). The issue arises whenever an amount of expenditure is incurred only partly for making taxable supplies. Whenever a vendor incurs expenditure only partially for making taxable supplies, and partially for making exempt or non-taxable supplies (also known as mixed purpose supplies), the amount of input tax claimable by that vendor should be apportioned, so that only the part relating to the making of taxable supplies is considered in the input tax return of that vendor, subject to the *de minimis* rule that is discussed below. This principle is set out in section 17(1) of the VAT Act and reads as follows:

Where goods or services are acquired or imported by a vendor partly for consumption, use or supply (hereinafter referred to as the intended use) in the course of making taxable supplies and partly for another intended use, the extent to which any tax which has become payable in respect of the supply to the vendor or the importation by the vendor, as the case may be, of such goods or services or in respect of such goods under section 7(3) or any amount determined in accordance with paragraph (b) or (c) of the definition of “input tax” in section 1, is input tax, shall be an amount which bears to the full amount of such tax or amount, as the case may be, the same ratio (as determined by the Commissioner in accordance with a ruling as contemplated in Chapter 7 of the Tax Administration Act or section 41B) as the intended use of such goods or services in the course of making taxable supplies bears to the total intended use of such goods or services.

The requirement to apportion input tax to the extent of making taxable supplies ensures that the neutrality principle, as previously discussed, is met. When a vendor acquires goods or services for domestic or private use, the vendor will be the final consumer of those goods or services and should consequently bear the VAT liability on the acquisition thereof since VAT is a consumption

tax. This is achieved by denying the vendor of an input tax deduction, resulting in the vendor paying the output tax on the purchase of the goods or services but not being able to claim the input tax thereon. The VAT on these goods or services, that are not used for making taxable supplies, will therefore not flow through the business but will stop at the vendor i.e., the consumer in this instance.

Although the above-mentioned section makes it clear that an apportionment for taxable use is required, the VAT Act itself does not provide any guidance on how this apportionment should be made. From 29 June 1998, VAT vendors have to apply an apportionment method prescribed by SARS in line with a ruling envisaged in section 41A or section 41B of the VAT Act. However, section 41A has since been repealed and only section 41B is currently applicable. Before this date the VAT Act did not provide SARS with any discretionary authority to prescribe an apportionment method to be used by vendors (Smit, 2009:18-19). Nonetheless, up to 1 November 2000, the VAT 404 guide for vendors (published by SARS) only permitted a taxpayer two methods of apportionment, namely the input-base method of apportionment and the turnover-base method. A vendor was able to select the apportionment method that best reflected their enterprise's VAT enactment. In instances that neither of the two methods was appropriate to the vendor's business, the taxpayer could apply to SARS for consent on an alternative method. Such alternative methods included, amongst others, methods based on inputs, floor space, transaction count and employee time spent (Jembula, 2020:2). However, in August 2000 SARS announced in VAT News publication no.15 (SARS, 2000:2) that, with effect from 1 November 2000, the only pre-approved method for apportionment will be the turnover-based method. Any vendor seeking to use an alternative method would have to apply for written approval from SARS. Nevertheless, SARS allowed taxpayers, who already received approval from the Commissioner to use an alternative method prior to this date, to continue apportioning their input tax according to that method without requiring re-approval. This announcement provides taxpayers with certainty on the methods available to apportion their input tax on mixed purpose supplies. Taxpayers can either use the STB method or alternatively apply for a method to be approved by SARS.

3.3.1 The standard turnover-based method

As a result of difficulty in applying the turnover-based method of apportionment, SARS issued a Binding General Ruling (BGR 16) on 25 March 2013 to assist taxpayers in making the necessary apportionment by prescribing a specific method to be used in determining the ratio contemplated in section 17(1) of the VAT Act. Accordingly, SARS set out a formula known as the standard turnover-based method of apportionment. This BGR has subsequently been revised and Binding General Ruling 16 (Issue 2) was published on 30 March 2015 and took effect on 1 April 2015.

The main alteration related to the purpose of the BGR. The initial purpose of the first issue was that “this BGR reproduces the statement in paragraph 8.4.3 of the Value-Added Tax Guide for Vendors (VAT 404) under the heading “Formula: Turnover-based method of apportionment”, which comprises a BGR under section 89 of the TA Act” (SARS, 2013:1). This statement was replaced in the second issue with “this BGR prescribes the method to be used in determining the ratio contemplated in section 17(1)” (SARS, 2015:1). This version is set to apply for an indefinite period i.e., until it is withdrawn, or the relevant legislation is amended. Currently, this method is the only pre-approved method of apportionment available to taxpayers but may only be used on the condition that it is a fair and reasonable representation of the taxpayer’s VAT enactment. The formula for the standard turnover-based method as set out in BGR 16 is as follows:

$$Y = \frac{a}{a+b+c} \times \frac{100}{1}$$

Where:

“y” = the apportionment ratio/percentage;

“a” = the value of all taxable supplies (including deemed taxable supplies) made during the period;

“b” = the value of all exempt supplies made during the period; and

“c” = the sum of any other amounts not included in “a” or “b” in the formula, which were received or which accrued during the period (whether in respect of a supply or not).

According to the VAT 404 guide for vendors, the turnover-based ratio is calculated based on the information contained in the vendor’s business financial statements. In instances where the income amount comprises both taxable and non-taxable supplies, vendors should ensure they keep accurate record to split the income between the different types of supplies (SARS, 2022a:68). The VAT Act requires a vendor to determine its apportionment ratio in each tax period. However, due to the practical difficulty of accurately determining the apportionment percentage according to the turnover-based method in each and every tax period as required, a vendor is allowed to determine the percentage based on the previous year’s figures for each VAT period. The vendor can then apply this percentage to calculate the input tax deduction for the relevant VAT periods. Consequently, an adjustment is required for any shortfall or overestimation of the ratio applied when the audited financial statements are available, and the actual ratio can be calculated.

In instances where the taxable use is equal to or exceeds 95% of the total use or consumption, a taxpayer will be allowed a full input tax deduction. This is also known as the *de minimis* rule. The rule originally allowed a full input tax deduction, should a taxpayer's taxable supplies equal or exceed 90%, but the rule was amended in 1999 and provided for an increase in the *de minimis* rule percentage of 5%. SARS issued an Explanatory Memorandum on the Revenue Laws Amendment Bill stating that "although the 90 per cent use for making taxable supplies appears to be high, substantial amounts of VAT are lost as a result of this concession. The proviso is accordingly amended to increase the percentage to 95 per cent" (SARS, 1999:40).

The implementation of BGR 16 was unfortunately not the ultimate solution to all apportionment issues. As mentioned, in circumstances where the standard turnover-based method fails to provide a reasonable estimate of the degree of taxable application of the enterprise's VAT inclusive expenditure, the vendor can apply to SARS for an alternative, more appropriate method of apportionment which is granted by way of a VAT ruling. The application process for a VAT ruling is discussed in part 3.4 of this chapter.

3.3.2 Concerns regarding the standard turnover-based method

As a result of component "c" in the formula requiring vendors to include the sum of any other amounts not included in "a" or "b" in the formula, which were received or which accrued during the period (whether in respect of a supply or not), the standard turnover-based method is seldom a fair representation of the degree to which a taxpayer applies their resources for making taxable supplies. The terms received and accrued mentioned in component "c" of the formula are not defined in the VAT or Income Tax Acts. However, many years ago the High Court ruled in the *Geldenhuys v CIR* (1947) case that received means to receive an amount on your own behalf and for your own benefit and in *CIR v People Stores (Walvis Bay) (Pty) Ltd* (1990), that accrued refers to a person's unconditional entitlement to an amount (Ernst & Young, 2011). According to SARS, this means that vendors must include any realised gains on foreign exchange transactions, dividends, and interest income in the denominator of the formula (Ernst & Young, 2011).

However, tax specialists such as Badenhorst (2021) and Marais (2014:52) argue that no direct or indirect taxable expenditure are necessarily incurred to produce dividends or interest on excess funds in a bank account. Consequently, interest and dividends are incorporated into the formula on the assumption that resources are used to produce dividends and interest in the same way as producing taxable supplies, thereby distorting the accuracy of the ratio (Badenhorst, 2021). Discussions with SARS aimed at removing these items from the formula in fitting circumstances have been constantly unsuccessful (Ernst & Young, 2011). This distortion consequently reduces

the neutrality and fairness of the tax, as explained in the second chapter of this study, since the taxpayer is prevented from claiming input tax to the extent of making taxable supplies.

These distortions will result in taxpayers applying to SARS for alternative apportionment methods. However, these alternative apportionment methods are predominantly granted with prospective effect which may be regarded as counter intuitive and unjust (Jembula, 2020). This limitation arises from proviso (iii) to section 17(1) of the VAT Act, stating that:

where a method for determining the ratio referred to in this subsection has been approved by the Commissioner, that method may only be changed with effect from a future tax period, or from such other date as the Commissioner may consider equitable and such other date must fall –

(aa) in the case of a vendor who is a taxpayer as defined in section 1 of the Income Tax Act, within the year of assessment as defined in that Act; or

(bb) ...

during which the application for the aforementioned method was made by the vendor.

Therefore, vendors will be obliged to apply the standard turnover-based method for an entire VAT period if they do not request SARS to approve an alternative method timeously. This will result in taxpayers being unable to claim material inputs for previous VAT periods, with no option of retrospective application of a fair and reasonable method. Similarly, vendors who fail to apply for renewal of their VAT ruling before the end of the next fiscal year will also be required to apply the STB method, thereby losing out on substantial input tax claims despite the business operations remaining unchanged. Badenhorst (2021) is of the opinion that the prohibition of retrospective application is in direct contrast with the context and strategy of the VAT system since input tax claims are allowed to the extent of making taxable supplies and the time period should therefore be irrelevant. Furthermore, Badenhorst (2021) claims that BGR 16 requires imperative amendments since the default method is not representative of most vendors' tax application.

A study conducted by Marais (2014) titled "A critical evaluation of the enterprise concept and the effect thereof on input tax and its apportionment for VAT purposes" also found that the default method available to a taxpayer i.e., the turnover-based method, is rarely suitable for vendors to apportion their input tax. His study focused on the VAT treatment by businesses to ensure accurate input tax deductions. In his study, Marais (2014:5) concentrated on the distinction between enterprise and non-enterprise activities as well as on the direct attribution rules where it

relates to both single and multiple supplies. Marais (2014) claims that the first step to determine whether tax payable on the acquisition of goods and services qualifies for an input tax deduction, is to ascertain whether the acquisition forms part of the taxpayer's enterprise or non-enterprise activities. Non-enterprise activities are passive activities i.e., activities that fall within the sphere of the vendor's business, but that are not continuous (Marais, 2014:5). Tax payable on the acquisition of these non-enterprise activities cannot be claimed as input tax. However, expenditure incurred on enterprise activities is deductible if it is incurred for making taxable supplies and not exempt supplies, since exempt supplies are excluded from the definition of an enterprise. Yet, it is important to note that taxable supplies include both standard rated and zero-rated supplies. It is in instances where expenditure relates to both taxable and non-taxable supplies where input tax must be apportioned. Marais (2014:52) claims that the only pre-approved apportionment method allowed by SARS, the standard turnover-based method, presumes that the total goods and services acquired by the vendor are applied in his business in the same ratio as taxable supplies relate to the total supplies, and that this presumption will result in vendors applying for alternative apportionment methods since this ratio will not necessarily be a fair and reasonable reflection of the vendors' tax application. He explains this by means of an example, stating that income items such as interest and dividends require much less cost in comparison to the vendor's normal supplies. Consequently, the apportionment ratio will not yield a fair and reasonable reflection of the taxpayer's manner of applying resources for taxable and non-taxable supplies, since expenditure incurred cannot be attributed in the same ratio as taxable income to total income. Badenhorst (2021) is of a similar viewpoint. According to him no direct or indirect taxable expenditure are necessarily incurred to produce dividends or interest on excess funds in a bank account. Consequently, interest and dividends are incorporated into the formula on the assumption that resources are used to produce dividends and interest in the same way as producing taxable supplies, thereby distorting the accuracy of the ratio (Badenhorst, 2021). This distortion brings the neutrality and equity of the current input tax methodology, as discussed in Chapter 2, into question.

In addition to the accuracy of the ratio being distorted as mentioned by Marais (2014:52) and Badenhorst (2021), Smit (2009:1-2) explains that uncertainty can arise at the interpretation of the inputs relevant to the turnover-based method. He claims that taxpayers are doubtful regarding which income or revenue amounts they should include when calculating the total supplies amount in the apportionment calculation (denominator). Where uncertainty arises amongst taxpayers, it is an indication that the tax has become too complex. Smit (2009:7) is of the opinion that the majority of textbooks only focus on providing general information on apportionment, while only a few give a proper indication of how the methods should be applied and the effect of this

application. Although the standard turnover-based method is the only pre-approved method of apportionment, various other methods exist and includes methods based on varied inputs, floor space, employee time spent, and transaction count (Jembula, 2020). Taxpayers should consider the appropriateness of all the different methods in order to ensure equity. Smit (2009:1-2) further explains the inconsistency of the turnover-based method through an example of the financial services sector. This sector uses the net interest received in the turnover-based method, which is not a well-known method. The end result of the method will vary by including different bases of taxable and non-taxable amounts in the calculation and consequently the amount of input tax claimable by the taxpayer will also vary. This raises the question whether this method is acceptable, since a more favourable method for the taxpayer does not necessarily result in a suitable apportionment ratio.

Smit's (2009:1-2) argument with regard to the uncertain application of the turnover-based method is further supported by a study conducted by Ritchie (2014:14) that revealed the difficulty for credit retailers to determine an accurate apportionment ratio when using the standard turnover-based method. She explains the impossibility for credit retailers to precisely split their supplies between taxable supplies (standard rated and zero-rated supplies) and non-taxable supplies (exempt supplies). Interest income on the provision of credit is a financial service in terms of section 2 of the VAT Act and will therefore qualify as an exempt supply in terms of section 12(a) of this Act, while the sale of goods will qualify as a taxable supply in terms of section 7(1)(a). However, Ritchie (2014:14) explains that "the credit retailer's intention is to increase the sales of their merchandise and credit is a means to this end. The interest earned is not a goal of the transaction but rather a by-product". However, it is argued by SARS that the above-mentioned retailer's intention is to earn income on the sale of goods as well as to earn interest income on the provision of credit and consequently, retailers have to make an apportionment for input tax purposes on expenditure incurred when, in essence, their objective is to make 100% taxable supplies. The principles of certainty and fairness, as discussed in Chapter 2, relating to the pre-approved apportionment method are consequently brought into doubt since some taxpayers are required to apportion their input tax based on, according to them, unreasonable grounds while some taxpayers are uncertain as to which amounts to include as part of the inputs to their apportionment calculation.

A study conducted by Nelson (2015:85) reveals the challenges relating to alternative apportionment methods available for taxpayers. He is of the opinion that the varied input-based method of apportionment approved by SARS for use by universities is not a long-term solution since the difficulty in applying the method and the financial burden it creates, makes the application thereof impracticable. Since universities' activities no longer consist of only educational services, which are exempt in terms of section 12(h)(i)(bb) and section 12(h)(ii) of the

VAT Act, but comprise a large proportion of research activities as well, a substantial portion of their income relates to taxable supplies and not only exempt supplies. This resulted in SARS issuing VAT class rulings (VCRs) explaining how they treat research activities conducted by universities and the effect thereof on the apportionment methods. The VCRs conclude that certain research activities meet the definition of an enterprise and consequently the varied input-based method of apportionment was created for universities. Nelson (2015:60) explains that in order for the varied input-based method to work effectively, higher education institutions are faced with an enormous task to identify the different income and expenditure streams and code it correctly according to the VCRs. He says that the greater part of universities does not have the required expertise or time to determine the apportionment ratio and consequently have to use professional consulting services which are tremendously expensive. Therefore, the varied input-based method is not the ultimate solution and other methods should be considered.

Hence, the issue of using an accurate apportionment ratio is not confined to a specific industry, but rather affects certain business models where turnover does not accurately reflect the consumption of their inputs. The issues relating to the apportionment of input tax and the methods available to taxpayers to make these apportionments may therefore fail the principles of a good tax system in certain circumstances.

3.4 Application process for an alternative apportionment method

In instances where the standard turnover-based method of apportionment fails to provide a vendor with a fair and reasonable result, the vendor should apply to SARS for a VAT ruling allowing them to use an alternative apportionment method (VATupdate, 2021). A VAT ruling is a written statement issued by the Commissioner upon an application under section 41B of the VAT Act, read with Chapter 7 of the Tax Administration Act 28 of 2011, regarding the interpretation or application of the VAT Act to a specific set of facts and is binding on the Commissioner only (SARS, 2021a).

The process for obtaining a VAT ruling starts by submitting a VAT ruling application to SARS and ends with the issuing of a VAT ruling which is signed by a designated senior SARS official (SARS, 2023b:3). A completed and signed VAT301 form should accompany the application. The VAT301 form requires the applicant to declare, amongst others, that the rejections under section 80 of the Tax Administration Act 28 of 2011 do not apply, the applicant has conformed to all the applicable tax obligations, and particulars included in the application are correct. Furthermore, in addition to the minimum information required to be included as part of the application, as prescribed under section 79(4) of the Tax Administration Act 28 of 2011 but excluding sections 79(4)(f), (k), (6) and

81(1)(b), SARS stipulates in the VAT rulings process reference guide (SARS, 2023b:5-6) that an application to use an alternative method of apportionment must include the following information:

- *A complete description of all the business activities, including whether or not income was received from such activities.*
- *Details of specific transactions that may impact SARS's decision-making process.*
- *A list of all income streams, including the value thereof, and whether or not such income results from various business activities carried on by the business. Also indicate whether those income streams are treated as taxable, exempt or out-of-scope for VAT purposes.*
- *Any possible changes to the business activities or income streams in the past or near future that may have an impact on the apportionment ratio.*
- *Annual Financial Statements for the past three years.*
- *A list of all expenses (including the values thereof) that are –*
 - *directly attributed (that is, being applied wholly) to the making of taxable supplies;*
 - *directly attributed (that is, being applied wholly) to the making of exempt supplies or for other non-taxable purposes (including income received that does not result from a supply made);*
 - *subject to the requested apportionment method, that is, mixed expenses.*
- *A detailed explanation as to why –*
 - *apportionment is required, that is, why expenses are regarded as being for mixed purposes;*
 - *the standard turnover-based method in Binding General Ruling (BGR) 16 "Standard Apportionment Method" is considered not to be fair and reasonable in the circumstances, or why it is inappropriate;*
 - *the proposed alternative method or methods that are considered to be more fair and reasonable or appropriate taking into account the specific circumstances the enterprise.*
- *A clear indication as to the preferred apportionment method and a detailed analysis of every inclusion or exclusion in that method.*
- *The outcomes and analysis of at least two other apportionment methods considered (other than the one in BGR 16) or an explanation as to why any other methods of apportionment commonly used by vendors cannot be applied.*
- *Detailed calculations of the apportionment ratio for three consecutive years (from the latest information available) for the standard turnover-based method and the two*

alternative apportionment methods that have been considered. The calculation must clearly indicate how the numbers or values used in the calculations are determined.

- *A statement in the ruling application as to whether input tax has been deducted in past tax periods using any method other than the one prescribed in BGR 16, and if so, from when that method was applied.*
- *A copy of any previous ruling(s) issued within the past five years permitting the vendor to use an alternative method of apportionment.*

Once the VAT ruling application has passed the pre-acceptance and compliance stage conducted by SARS, the allocation process commences and the vendor can expect the VAT ruling to be issued within 23 to 69 days from the date the application has been accepted, depending on the complexity of the matter (SARS, 2023b:13). Once completed, the VAT ruling will be sent to both the physical address and email address specified in the VAT ruling application (SARS, 2023b:15). Subject to certain requirements and limitations, a VAT ruling is binding on SARS (SARS, 2023b:15).

Furthermore, SARS may only publish a ruling (in a sanitised form) provided the applicant to which such ruling has been issued consents to such publication (SARS, 2023b:17). These rulings cannot be applied in general by other taxpayers and a third party can therefore not depend on a VAT ruling issued to another vendor, even if the facts of the transactions are similar. A VAT ruling may also not be quoted in any proceeding before SARS or the courts, unless that proceeding involves the applicant (SARS, 2023b:16). The ruling does not constitute a practice generally prevailing as envisaged in section 1 of the Tax Administration Act (SARS, 2023b:17).

When considering the principles of a good tax system as discussed in Chapter 2, the transparency of these rulings becomes questionable since VAT rulings are distributed to the applicant alone and are consequently not available for other vendors to evaluate if the applicant does not give SARS consent to make the ruling publicly available. Third party vendors may therefore not be able to assess whether the tax they are expected to pay is fair in comparison to the tax liability of others.

Furthermore, the application for a VAT ruling is an administrative intensive process when considering the comprehensive list of information that is required to be submitted to SARS. This process consequently results in a taxpayer having to spend significant time and effort to gather all the necessary information in order to get approval for an alternative apportionment method. However, SARS may also bear an additional administrative and cost burden in this respect since sufficient resources have to be acquired to manage this process. It is therefore questionable

whether the system adheres to the principle of administrative ease where an application for the approval of an alternative apportionment method is submitted.

3.5 Change in use adjustments

In terms of section 18(1), 18(2), 18(4) and 18(5) of the VAT Act, a VAT vendor is required to make an output or input tax adjustment (as the case may be), if the extent to which capital goods or services used by the vendor to make taxable supplies increases or decreases, or if goods or services are applied entirely for a different purpose than intended when acquired, manufactured, assembled, constructed or produced (SARS, 2022a:77).

The VAT 404 guide for vendors explains that an adjustment to output tax is required where goods or services acquired for making taxable supplies are later applied exclusively for private, exempt, or other non-taxable purposes, or where there is a decrease of more than 10% in the extent of taxable use by the vendor of capital goods or services which have an adjusted cost of R40 000 or more (SARS, 2022a:77). The first mentioned change will require an immediate adjustment, whereas the second change requires an annual adjustment made at the end of the tax period.

In contrast, an adjustment to input tax may be allowed where goods or services, applied exclusively or partially for non-taxable purposes, are later applied exclusively or partially for making taxable supplies, or where there is an increase of more than 10% in the extent of taxable use by the vendor of the capital goods or services. The first mentioned change will require an immediate adjustment, whereas the second change requires an annual adjustment made at the end of the tax period (SARS, 2022a:77).

When considering these sections of the VAT Act, it becomes clear that these rules enhance the fairness and equity of the tax as discussed in Chapter 2, since these sections protect the taxpayer against claiming too little input tax where the taxable use of a capital good or service increases. Similarly, the fiscus is protected from taxpayers claiming too much input tax where the taxable use of capital goods or services decreases.

3.6 Case law related to VAT apportionment

The approval methodology for input tax apportionment applied in South Africa has become quite a controversial matter due to the debatable interpretation of the legislation, BGR 16, and VAT guides. Due to the STB method rarely providing a fair and reasonable result of a taxpayer's VAT application and the variety of methods that can be applied *in lieu* thereof, many taxpayers have

challenged SARS's refusal of material input tax deductions based on alternative apportionment methods. In this section, recent cases dealing with VAT apportionment issues are discussed.

3.6.1 Mukuru Africa (Pty) Ltd v CSARS

The upfront approval methodology for input tax apportionment was recently subject to case law where it was subsequently published in case journal or Cape Town Tax Court – Case No: VAT 2063 (the original number). In this case titled *Taxpayer v Commissioner for the South African Revenue Service* (2019), SARS refused to approve retrospective application of a transaction count-based (TCB) method of apportionment for the taxpayer, namely Mukuru Africa (Pty) Ltd (hereafter referred to as Mukuru Africa), who provide money-transfer services within Africa, mobile phone credit and *bureau de change* services. The taxpayer's enterprise makes both taxable and exempt supplies and applied to SARS in 2017 for a ruling to approve the application of a transaction count-based method of apportionment under section 41B of the VAT Act from 1 February 2014 (the commencement date of the business). This would allow the taxpayer an input tax deduction for its mixed purpose supplies equal to an amount apportioned in the ratio of the number of taxable transactions to the total number of transactions. The taxpayer used an unapproved varied turnover-based calculation method instead of applying the standard turnover-based method as set out in BGR 16.

In November 2017, SARS issued a ruling whereby they approved the TCB method as requested by Mukuru Africa. However, the ruling only applied for tax periods starting on 1 March 2016. SARS was of the opinion that proviso (iii) to section 17(1) of the VAT Act prevented them from approving retrospective application of the TCB method beyond 1 March 2016, since this proviso states that an approved apportionment method can only apply to upcoming tax periods, or from another date considered by the Commissioner to be reasonable. Consequently, Mukuru Africa lodged an objection against this decision made by SARS.

At first SARS treated the objection as invalid, claiming that section 32(1)(a)(iv) of the VAT Act disallows such an objection. However, after Mukuru Africa applied to the Tax Court, requesting that SARS be obliged to decide on the objection, an order was granted by the judge and SARS accepted to determine the objection with costs to stand over. SARS once again refused retrospective application of the varied turnover-based method. SARS then contended that the Tax Court does not have the jurisdiction to govern the appeal available to a vendor under section 32(1)(a)(iv) of the VAT Act. According to this section, a vendor may object to, or appeal against a written decision provided by SARS where they refuse to approve an alternative apportionment method to determine the ratio contemplated in section 17(1) of the VAT Act. SARS argued that

they did not refuse the alternative apportionment method but refused the retrospective application thereof and it is therefore not a decision referred to in section 32(1)(a)(iv) of the VAT Act. However, the judge determined that the language of the provision cannot be strained to exclude retrospective application as it would give an unbusinesslike result which is doubtfully the intention of the legislation. Accordingly, the judge determined that the matter falls squarely within the Tax Court's jurisdiction.

Both SARS and Mukuru Africa agreed that the TCB method is an appropriate apportionment method for Mukuru Africa's business operations. The issue was whether SARS was prohibited by proviso (iii) to section 17(1) from approving retrospective application of this method i.e., from 1 March 2014 to 29 February 2016.

Mukuru Africa was of the view that the STB method, as set out in BGR 16, cannot apply to any year of assessment where it is not a fair and reasonable reflection of the VAT application, as required by the binding general ruling. They argued that BGR 16 does not stipulate a compulsory method to apportion input tax on mixed purpose supplies in cases where the STB method is not fair and reasonable. Therefore, Mukuru Africa applied in 2017 for a VAT ruling to use an alternative method of apportionment, effective from 1 March 2014. Although the VAT ruling was approved and issued by SARS, the period was only from 1 March 2016. SARS contended that proviso (iii) to section 17(1) of the VAT Act only allows them to approve such alternative method "with effect from a future tax period, or from such other date as the Commissioner may consider equitable" or in cases where it is not changed from a future tax period it can only be altered from "such other date", provided the vendor is a taxpayer, "within the year of assessment as defined in that Act...during which the application for the aforementioned method was made by the vendor".

The Tax Court stated that the law provides flexibility by allowing the use of alternative apportionment methods in cases where the STB method is not appropriate, to ensure taxpayers receive appropriate input tax deductions. However, they held that when the context and purpose of proviso (iii) to section 17(1) is considered there is no reason why a time limit on retrospective application of an alternative method cannot be imposed, since this assists in giving the proviso a practical and efficient interpretation. The court further held that a sensible interpretation of this proviso would not allow for such retrospective application as requested by Mukuru Africa, since it will compromise the language, context, purpose, and intention of the section.

The Tax Court concluded that the mere fact that SARS accepted the application of the TCB method in 2017 and accepted that the turnover-based method is not a fair and reasonable

apportionment method, does not mean that this was the case for the 2014 to 2016 years of assessment, and it cannot be interpreted as such. Furthermore, the Tax Court stated that the turnover-based method as set out in BGR 16 was the only ratio applicable to the vendor up until the VAT ruling to apply the TCB method was approved in 2017, and that proviso (iii) to section 17(1) prohibited SARS from granting retrospective application of the VAT ruling before 1 March 2016.

Subsequent to Mukuru Africa's case failing in the Tax Court, the taxpayer appealed to the judgement made by this court and the case escalated to the Supreme Court of Appeal (the SCA). In the case *Mukuru Africa (Pty) Ltd v Commissioner for the South African Revenue Service* (2021) the primary issue was still whether SARS was prohibited to retrospectively allow the TCB method of apportionment for Mukuru Africa's 2014 to 2016 years of assessment in terms of proviso (iii) to section 17(1). Mukuru Africa continued its argument that BGR 16 did not apply to their business and therefore the VAT ruling issued by SARS did not create a change in apportionment methods and therefore retrospective application is not precluded by the proviso.

The SCA referred to paragraph 8.4.3 of the VAT 404 guide for vendors that states:

The only approved method which may be used to apportion VAT incurred for mixed purposes without specific prior written approval from the Commissioner, is the turnover-based method. This method applies by default in the absence of a specific ruling obtained by the vendor to use another method as there is usually a fairly good correlation between the turnover of a business and the resources (or inputs) which are employed to produce that turnover.

This implies that the STB method applies to all vendors that make mixed purpose supplies and have to apportion their input tax deduction as required by section 17(1), until such time that an alternative method has been approved by SARS. Therefore, the STB method applied to Mukuru Africa until their VAT ruling was issued by SARS. The court further held that the fair and reasonable condition of BGR 16 does not refer to the ratio itself, but rather to the obligation to apply to SARS for an alternative method in cases where the STB method renders inappropriate results. Hence, Mukuru Africa was wrong to assume that no approved apportionment method applied to their operations on commencement of their business.

Therefore, Mukuru Africa's application was indeed to change from the STB method to the TCB method and therefore SARS had no right to approve retrospective application of this method prior to 1 March 2016. The appeal made by Mukuru Africa failed once again since the Supreme Court

of Appeal concluded that the Tax Court was correct in its judgement and the case was consequently dismissed with costs.

Badenhorst (2019) claims that “it was common cause in Case No VAT 2063 that the STB method as prescribed by BGR 16 did not yield a fair and reasonable apportionment ratio, and that the TCB method was a suitable or appropriate apportionment method for the taxpayer’s enterprise”. Nonetheless, the Tax Court delivered a verdict that the taxpayer had to apply the standard turnover-based method, despite the fact that it was not a fair reflection of the extent to which the taxpayer made taxable supplies in those previous years of assessment. The taxpayer was consequently required to apply an improper apportionment ratio to their 2014 to 2016 years of assessment. When a taxpayer is obliged to apply an inappropriate apportionment method, the objective of the VAT Act is overruled (Badenhorst, 2019).

Subsequent to the final ruling, SARS (2021b) issued commentary on the case in VAT Connect Issue 13. VAT Connect is an information guide and not an official publication as defined in section 1 of the Tax Administration Act 28 of 2011. According to them, the effect of the judgement made by the Supreme Court of Appeal is that vendors must regard the STB method to be the default method of apportionment unless or until a VAT ruling has been issued to that vendor allowing them to apply a different method. Furthermore, vendors should note that they cannot escape the consequences caused by their non-compliance of not apportioning input tax in prior years, when they were required to do so, by applying for a VAT ruling to use a different apportionment method taking effect from a date in the past since this is prohibited by proviso (iii) to section 17(1) of the VAT Act.

As discussed under the neutrality principle in Chapter 2, the VAT system should ensure that the tax burden does not rest with the intermediaries in the supply chain, by allowing a full input tax deduction at each stage (provided it is used wholly for making taxable supplies). However, in this instance the taxpayer (Mukuru Africa) was unable to deduct the full amount of input tax incurred for the making of taxable supplies for their 2014 to 2016 years of assessment. Therefore, a portion of the tax burden did fall on Mukuru Africa since they were obliged to use an apportionment method not reflective of their tax application. Consequently, it seems as if the neutrality principle is absent in this instance.

3.6.2 CSARS v Tourvest Financial Services

In the case *Commissioner for the South African Revenue Services v Tourvest Financial Services (Pty) Ltd* (2021) an appeal was made against the decision by the Tax Court in Gauteng that the

company should not apportion their input tax deductions as required by section 17(1) of the VAT Act, since the inputs acquired by the business are used wholly for making taxable supplies.

Tourvest Financial Services (the respondent) is a licenced dealer in foreign exchange and trades under the name American Express Foreign Exchange. This business comprises 52 branches throughout the country as well as a head office and a centralised treasury division. The treasury division is responsible to acquire foreign currencies and then set the exchange rate at which the branches should buy and sell the foreign currencies. A profit margin in favour of Tourvest is included in the quoted rates. The rate at which the foreign currencies is trading is set by taking the market exchange at any given time and adding the mark-up thereto. Put simply, the company makes profit by selling foreign currencies to customers at rates above their acquisition price and buying foreign currencies from customers at prices below the price they expect to sell the currency. Additionally, a commission based on a percentage of the transaction value is also charged to the customer. VAT will consequently be levied on the commission.

The business is operated by acquiring foreign currency stock at the supplier's rate and then hedging the foreign currency risk by preserving an overdraft of the exact value, denominated in the same foreign currency. This strategy reduces their risk since their position is equalised between the foreign overdraft and foreign currency held. Tourvest then closes out its net foreign exchange position from time to time and it is only at this stage that the final margin is determined.

Before September 2013, Tourvest apportioned its input tax in terms of section 17(1) on the basis that not all VAT on acquisitions constitute deductible input tax. This apportionment was made on the basis that the company acquired goods or services partially for making taxable supplies and partially for making exempt supplies. However, in September 2013 the company claimed an input tax deduction of R24 389 036.58 with the argument of having overpaid VAT in its previous five years. Tourvest contended that no apportionment is required since the company essentially only makes taxable supplies and consequently claimed input tax for the VAT they overpaid in prior years. Initially, the Commissioner paid back the amount in November 2013. However, after a further audit conducted in 2016, SARS raised an additional assessment whereby they added back the R24 389 036.58 input tax claim. SARS reasoned that the acquisitions related to goods and services used for mixed purpose supplies and therefore input tax must be apportioned. Tourvest objected to this assessment and after the objection failed, they appealed to the Tax Court, after which it succeeded with costs.

The Tax Court held that (based on the facts and evidence in their possession) the commission paid by the customer to Tourvest is the only form of payment in exchange for the foreign currency.

They also found that the notional margin (the gross profit made up of trading the stock) does not form part of the agreement between Tourvest and the customer, since neither party is certain when the transaction will be closed at the branch and therefore the court rendered it irrelevant for this case. Financial services are listed in section 2(1) of the VAT Act and is, according to section 12(a), exempt from VAT imposed under section 7(1)(a). As stipulated in section 2(a) of the VAT Act, financial services specifically include “the exchange of currency (whether effected by the exchange of bank notes or coin, by crediting or debiting accounts, or otherwise)”. However, the proviso to this section states that these services will be deemed not to be financial services in instances where the consideration therefore constitutes any fee, commission etc. and will consequently not be exempt. Since the Tax Court found that the commission is the only form of consideration, they concluded that, in this instance, the exchange of foreign currency would not be exempt as it would not qualify as a financial service and therefore the company only makes taxable supplies.

On appeal by SARS to the decision made by the Tax Court, the primary issue of this case remained whether the respondent (Tourvest) makes mixed purpose supplies and should consequently apportion their input tax in accordance with section 17(1), or whether they make only taxable supplies, in which case no apportionment is necessary.

The Supreme Court of Appeal held that although the VAT Act originally treated the exchange of currency as an exempt financial service, the proviso to section 2(1) of the VAT Act came into effect in 1996, making fee-based financial services subject to VAT. This change resulted in a commission charge to attract VAT. In this case the entire supply would have been exempt if no fee was charged, resulting in no input tax claimed. However, in terms of the proviso to section 2(1), the exchange of foreign currency, for a fee or commission, deems the service not to be a financial service. The SCA clarified that the proviso’s only intention is to bring financial services into the VAT net but does not result in the supply losing its exempt nature completely. The supply will remain exempt for all other purposes, while only the taxable element carries VAT. Therefore, the proviso did not result in the supply losing its exempt nature but created a mixed nature of such supply instead, thereby turning the supply into partly taxable and partly exempt.

The SCA therefore concluded that any VAT paid by the respondent on the acquisition of goods and services would require apportionment and the input tax claim was consequently denied.

When considering the studies conducted by Ritchie (2014:14), on the difficulty for credit retailers in determining an accurate apportionment ratio when using the standard turnover-based method, and Smit (2009:1-2), on the uncertainty regarding the interpretation of the inputs to the turnover-

based method, that were previously discussed, it appears as if the rules regarding VAT apportionment is vague for taxpayers. Many taxpayers are uncertain as to which amounts to include in the calculation for apportionment. This uncertainty may consequently result in taxpayers applying inappropriate methods that are later rejected by the fiscus.

The court cases discussed above reveal the controversy when it comes to input tax and the apportionment thereof. Based on the rulings made by the Supreme Court of Appeal in these cases, both taxpayers lost material amounts of input tax deductions by following a different interpretation of the VAT Act and its rulings than that of SARS and the SCA. This may reveal possible flaws relating to the regulations governing input tax apportionment, thereby causing disagreements between the taxpayer and SARS. In both cases the SCA sided with SARS, which may bring the objectivity and neutrality of the VAT system into doubt, since these taxpayers had valid arguments. The Mukuru Africa case supports the need to consider alternative approval methods for input tax apportionment in South Africa since it is inappropriate to force a taxpayer to use an apportionment method that does not fairly reflect its tax matters. The Tourvest case, on the other hand, necessitates reconsideration of the clarity regarding mixed purpose supplies and the methods used to apportion input tax where mixed purpose supplies are made.

3.7 Chapter conclusion

This chapter reveals the concerns surrounding the current input tax apportionment methodology followed in South Africa and the related issues with the approval thereof. The findings of this chapter are as follows:

a) **Neutrality**

The analysis revealed the questionability of whether the standard apportionment method, as prescribed by the Commissioner, and the approval of alternative methods result, in certain circumstances, in a neutral outcome for either the taxpayer or the fiscus.

b) **Certainty**

Although the VAT system provides taxpayers with certainty on the methods available to apportion their input tax, some uncertainty may arise regarding the interpretation of the standard turnover-based method. Some taxpayers may be uncertain as to which amounts they should include as part of the inputs to their apportionment calculation.

c) **Transparency**

On successful application for a VAT ruling approving an alternative apportionment method, the VAT ruling is issued to the applicant alone and is not made available to the general public without the consent of the applicant. The transparency of these rulings is

accordingly questionable since other taxpayers may not be able to assess whether the taxes they are expected to pay are fair in comparison to the tax liability of others.

d) Administrative ease

The process surrounding the application and approval of alternative apportionment methods may result in both the taxpayer and the fiscus having to incur a significant amount of time and money to apply for and approve the application, respectively. As a result, an administrative burden and undue compliance costs may be created for taxpayers and the fiscus.

The need to consider alternative and more efficient approval methods, which better conform to the principles of a good tax system, is therefore highlighted. This creates the opportunity to evaluate other countries' approval methodologies as it relates to input tax apportionment in order to determine whether an alternative method can possibly be implemented in South Africa.

4 Chapter 4 Detailed analysis of Australia's GST system

This chapter consists of a detailed analysis of the GST system implemented in Australia. This chapter concentrates on the country's GST background, registration requirements, input credits and apportionment methodology as it relates to input tax credits. Thereafter, a comparison is drawn between the GST system implemented in Australia and that of South Africa, with a focus on the input tax apportionment methodology implemented in each country. This detailed analysis allows for an appropriate comparison when considering the principles of a good tax system as discussed in Chapter 2.

4.1 Background and functioning of the Australian GST system

In July 2000, the federal government of Australia introduced a goods and services tax (GST) that is based on the value-added tax concept. The legislation was passed on 28 June 1999 as *A New Tax System (Goods and Services Tax) Act* of 1999 and came into effect on 1 July 2000 (Datt et al., 2016:5). This implementation formed part of a broader package of taxation reform and was executed as a replacement for wholesale sales tax (WST) together with other ineffective state taxes (Reinhardt & Steel, 2006). GST is a broad-based, indirect tax levied at 10% on most goods and services sold or consumed in Australia. The tax is payable on taxable supplies and taxable importations. Taxable supplies are defined in section 9-5 of *A New Tax System (Goods and Services Tax) Act* of 1999 (hereafter referred to as the GST Act) as follows:

You make a taxable supply if:

- (a) you make the supply for consideration; and*
- (b) the supply is made in the course or furtherance of an enterprise that you carry on; and*
- (c) the supply is connected with the indirect tax zone; and*
- (d) you are registered, or required to be registered.*

However, the supply is not a taxable supply to the extent that it is GST-free or input taxed.

An enterprise for GST purposes is defined in section 9-20 of the GST Act. The Australian Taxation Office (ATO) (2023b) summarises the definition as follows:

An enterprise includes a business as well as:

- *commercial activities*
- *activities of entities such as charities*
- *deductible gift recipients*
- *religious and government organisations*
- *certain non-profit organisations.*

It doesn't include:

- *private recreational pursuits and hobbies*
- *activities carried on as an employee, labour-hire worker, director or office holder*
- *activities carried on by individuals (other than trustees of charitable funds) or partnerships (all or most of the partners are individuals) without a reasonable expectation of profit.*

Furthermore, the ATO (2023b) summarises an indirect tax zone to mean Australia, excluding the external territories and certain offshore areas of Australia.

A business or other organisation will be obliged to register for GST when their annual GST turnover (gross income from all businesses minus GST) equals or exceeds A\$75 000. However, non-profit organisations will only have to register once their annual GST turnover equals or exceeds A\$150 000, while taxi or limousine travel services, including ride-sourcing, is obliged to register for GST regardless of their turnover. Voluntary registration is permitted for those businesses or enterprises that do not meet the above criteria on the condition that they remain registered for 12 months. Registration should occur within 21 days from the date that the business becomes liable to register (ATO, 2023a).

Goods or services that do not attract GST is known as GST-free sales (ATO, 2023b). In terms of section 9-30 of the GST Act, a GST-free supply refers to a supply made under division 38 of the Act or under a provision contained in another Act, or a supply of a right to receive a supply that would be GST-free under division 38 of the Act or under a provision contained in another Act. Division 38 sets out all types of supplies that are GST-free, and includes amongst others, items such as food, health, education, childcare, religious services etc. In addition, division 38 of the GST Act states that "if a supply is GST-free, then no GST is payable on the supply, and an entitlement to an input tax credit for anything acquired or imported to make the supply is not

affected". In other words, when a good or service is GST-free it is sold without GST included in the price and therefore no GST is payable to the tax authorities. Nonetheless, a supplier will still be able to claim input tax credits on the inputs acquired to make the GST-free supply (Pinto, 2000:12). The term GST-free is comparable to the term zero-rated used in countries with VAT systems, such as South Africa.

A supply is input taxed if stipulated as such in division 40 of the GST Act or under a provision of another Act. In addition, a supply will be input taxed if it is a supply of a right to receive a supply that would be input taxed in accordance with division 40 or a provision in any other Act. In terms of section 40-1, no GST is payable on the supply if the supply is input taxed. However, a vendor is also not allowed to claim an input tax credit for anything acquired or imported to make the input taxed supply. This means that consumers will indirectly bear the cost of GST since it will be incorporated into the price paid for input taxed supplies (Pinto, 2000:12). It is therefore similar to an exempt supply used in the South African VAT system. Division 40 of the GST Act contains all the types of supplies that are input taxed and includes, amongst others, supplies such as financial supplies, residential rent, residential premises, precious metals and some others.

In terms of section 9-30 of the GST Act, GST-free supplies override input taxed supplies. In instances where a supply is both GST-free and input taxed, the supply will be classified as GST-free and not input taxed, unless the provision under which it is input taxed necessitates the supplier to have selected for its supplies of that kind to be input taxed. Moreover, a supply will be classified as input taxed instead of GST-free where a provision stipulates the supplier to classify the supplies as such.

Similar to South Africa's VAT system, the Australian GST system is based on New Zealand's *Goods and Services Tax Act* 141 of 1985. Australia's GST system is based on the destination principle and therefore taxes consumers on goods or services consumed in Australia (Datt *et al.*, 2016:5). The invoice credit method is used, allowing both a cash and accrual basis of accounting. Although this tax has a wide scope, there are several items relating to health, medical care, education, childcare, food, and beverages etc. that are excluded from the tax base, as mentioned above (Datt *et al.*, 2016:5).

The total reported tax revenue for the 2020/2021 fiscal year was established at an amount of A\$496 734 million of which A\$72 620 million related to GST revenue. Consequently, GST as a percentage of total tax revenue amounted to approximately 14,6% and represents the third highest revenue source for the Australian Taxation Office, after the tax on individuals and

company tax (Maslaris & Robinson, 2022). Therefore, GST revenue is a substantial revenue source for the Australian government.

4.2 Input tax credits

GST is designed to tax the final consumer and to ensure that the tax is only paid on the value added by each supplier in the supply chain. Suppliers are consequently allowed to claim input tax credits for the GST paid on acquisition or importation of goods or services, if it is used for carrying on an enterprise (Seiden & Apkarian, 2017:68). However, suppliers are not allowed to claim input tax credits for goods or services acquired to make input taxed supplies, for purchases that do not have GST in the price, for wages payable to staff, or where a valid tax invoice is not available. Suppliers are required to have tax invoices in order to claim input tax credits, with the exception of purchases with a GST-inclusive value of A\$82.50 or less (ATO, 2022).

The GST system operates on output tax and input credits to avoid a cascading effect and to produce a net GST amount which should be paid to the Australian Taxation Office (Seiden & Apkarian, 2017:68). This principle ensures that the tax system is neutral to GST vendors (as discussed in Chapter 2) since the tax should only be payable on final consumption. The net GST amount, explained in section 7-5 of the GST Act, refers to the residual amount after amounts of GST and amounts of input tax credits for a tax period are set off against each other. The amount assessed as being the net GST amount for a tax period, as explained in section 7-15 of the GST Act, is the amount that the taxpayer is liable to pay to the Commonwealth, or that the Commonwealth should reimburse to the entity, in respect of the specific tax period.

In terms of section 7-1(2), a taxpayer is entitled to input tax credits on creditable acquisitions and creditable importations. Section 11-5 of the GST Act states that a creditable acquisition is made if:

- (a) you acquire anything solely or partly for a creditable purpose; and*
- (b) the supply of the thing to you is a taxable supply; and*
- (c) you provide, or are liable to provide, consideration for the supply; and*
- (d) you are registered, or required to be registered.*

In terms of section 11-15 of the GST Act, inputs are acquired for a creditable purpose to the extent that it is acquired to carry on an enterprise and excludes acquisitions made that relates to making input taxed supplies or the nature of which is for private purposes. Section 11-25 states that the

input tax credit for a creditable acquisition, amounts to the GST paid to the supplier on acquisition. Although, if the acquisition is only partly creditable, the input tax credit is reduced proportionally.

An acquisition will be classified as partially creditable when a creditable acquisition is only made partially for a creditable purpose, and/or the supplier is only responsible for a part of the consideration i.e., the supplier is not liable to pay the full amount of consideration. The input tax credit claimable by the supplier on the partly creditable acquisition is set out in section 11-30 of the GST Act and is calculated as follows:

$$\text{Full input tax credit} \times \text{extent of creditable purpose} \times \text{extent of consideration}$$

where:

extent of consideration is the extent to which you provide, or are liable to provide, the consideration for the acquisition, expressed as a percentage of the total consideration for the acquisition.

extent of creditable purpose is the extent to which the creditable acquisition is for a creditable purpose, expressed as a percentage of the total purpose of the acquisition.

full input tax credit is what would have been the amount of the input tax credit for the acquisition if it had been made solely for a creditable purpose and you had provided, or had been liable to provide, all of the consideration for the acquisition.

The Commissioner can determine, in writing, the appropriate methods that can be used to calculate the extent to which a creditable acquisition is made for a creditable purpose.

A creditable importation, as defined in section 15-5 of the GST Act, is made if:

- (a) you import goods solely or partly for a creditable purpose; and*
- (b) the importation is a taxable importation; and*
- (c) you are registered or required to be registered.*

As with creditable acquisitions, goods are imported for a creditable purpose if it is imported for the purpose of carrying on an enterprise. A taxable importation, in terms of section 13-5 of the GST Act, refers to goods that are imported and goods that are entered for home consumption. The amount of input tax credit allowed to be claimed for a creditable importation is an amount

equal to the GST payable on the importation. Yet, the amount of the input tax credit is reduced if the importation is only partially creditable.

Where an importation is made only partly for a creditable purpose, the input tax credit allowed to be claimed on that importation is determined as follows (as set out in section 15-25 of the GST Act):

$$\text{Full input tax credit} \times \text{extent of creditable purpose}$$

where:

extent of creditable purpose is the extent to which the importation is for a creditable purpose, expressed as a percentage of the total purpose of the importation.

full input tax credit is what would have been the amount of the input tax credit for the importation if it had been made solely for a creditable purpose.

The Commissioner can determine, in writing, how to calculate the extent to which an importation is made for a creditable purpose.

A supplier is not allowed to claim input credits on input taxed sales since these supplies are not subject to output tax. The most common forms of input taxed sales are financial supplies and the supply of residential premises for rent or sale (ATO, 2023b).

4.3 Apportionment of Australian GST

In instances where a business makes both taxable supplies and input taxed supplies, the extent to which acquisitions, and its associated GST, relate to the making of input taxed supplies must be determined, since no input tax credits may be claimed in respect of such supplies (ATO, 2023c). An apportionment of input tax credits may be necessary when determining the extent of a taxpayer's creditable purpose and should take into consideration whether the acquisition can be traced to a distinct supply or whether it is fungible. A methodology would need to be applied in order to identify GST on acquisitions to the extent that it does not relate to input taxed supplies, since input tax credits will be claimable on these acquisitions. When a taxpayer can only claim partial GST on the purchase of a good or service, there are two options to account for the GST credit. The taxpayer can either calculate the allowable GST credit and claim the amount on their monthly or quarterly activity statement, or the taxpayer can claim the entire GST amount on their monthly or quarterly statement and make an annual adjustment (ATO, 2022). However, the annual method is only available to small businesses with an annual turnover of less than A\$10

million or alternatively to enterprises which are not businesses with a GST turnover of A\$2 million or less, as set out in division 131 of the GST Act. Furthermore, taxpayers are only allowed to use the annual apportionment method on the condition that they lodge their returns on a monthly or quarterly basis (ATO, 2017).

According to the Australian Taxation Office (2023c), the methodology used by taxpayers to determine their allowable GST credits must be fair and reasonable. The method applied must reflect the use or intended use of the goods or services acquired to make input taxed supplies and other supplies. In order to determine the allowable GST credits that a taxpayer can claim on acquisitions made, relating partly to input taxed supplies, the taxpayer should firstly calculate the GST on acquisitions that relate solely to supplies that are not input taxed. Secondly, the taxpayer should verify whether there were any concessions for GST on the acquisition of input taxed supplies. Lastly, the taxpayer should apportion the GST on purchases related partially to the making of input taxed supplies (ATO, 2023c).

Moreover, the GST Act does not prescribe any specific apportionment method. The ATO accepts the fact that taxpayers will try to find a method that allows them to claim the maximum amount of GST credits that are fairly and reasonably claimable, while trying to minimize the cost of calculating such amounts (ATO, 2023c). However, the Australian Taxation Office (2023d) has set out a list of factors to be considered by taxpayers when choosing an apportionment method. These factors are listed below:

- *keep in mind that the purpose and outcome of the methodology is to measure the relationship between acquisitions and their intended or actual use*
- *be satisfied that the basis of apportionment makes sense in the context of your enterprise*
- *ensure there is a documented description of the business that demonstrates the intended or actual use of the acquisitions in a practical business context*
- *ensure you consider all relevant information and document it*
- *ensure that you do not consider irrelevant information*
- *consider alternative methods and assess them to determine those which are fair and reasonable and those that are not*
- *be conscious of the compliance cost of any method, having regard to the context (size, structure and nature) of your business*
- *be responsive to any changing circumstances in your business that may impact on whether your chosen methodology continues to be fair and reasonable.*

Furthermore, taxpayers are encouraged to assess whether their chosen apportionment method is fair and reasonable by ascertaining whether (ATO, 2023d):

- *the information is accurate and complete*
- *the information is likely to change in the near future*
- *you can fully explain your business activities, consumption of acquisitions and resources, and you have documented this*
- *you have accurately determined the classification of supplies*
- *there are any distorting elements in the methodology*
- *you applied the method consistently*
- *you used assumptions in the methodology that could be supported and continue to be relevant over time*
- *the method is overly complex and burdensome and causes unnecessary compliance costs*
- *the method is sufficiently sophisticated and appropriate to the nature, size, complexity and resourcing of your business*
- *the outcome is consistent with your documented understanding of the business activities and relationship or connection between acquisitions and supplies made.*

To give further guidance to taxpayers on the appropriate apportionment methodology to use when apportioning input credits, the Australian Taxation Office published a goods and services tax ruling (GSTR). GSTR 2006/4 aims to guide taxpayers in determining the extent of their creditable purpose when acquiring or importing goods or services to ensure that the correct input tax credits are claimed (ATO, 2020:1). It does so by giving various examples of apportionment methods that can be used by taxpayers when apportioning their input tax credits. This GSTR stipulates that the Commissioner permits a taxpayer to choose its own method of apportionment on the condition that the method is fair and reasonable and replicates the genuine or planned use of the acquisition (Seiden & Apkarian, 2017:73). A taxpayer is consequently not limited to the methods provided in the ruling (ATO, 2020:1).

GSTR 2006/4 (ATO, 2020:3) states that where an acquisition or importation is made only partly for a creditable purpose, a taxpayer must determine the extent of that creditable purpose. This extent is based on the planned use of the goods or services acquired or imported in the taxpayer's enterprise and is expressed as a percentage of its total use. The expression 'to the extent that' in

the perspective of input tax credit recoverability in the GST Act refers to the apportionment of acquisitions between several uses, as well as exclusive allocation to particular uses (ATO, 2020:3-4). The GSTR further states that an adjustment to the input tax credits claimed is required whenever the creditable purpose of the good or service acquired or imported changes. If the planned extent is less than 100% for a creditable purpose (but greater than zero) then the acquisition or importation is partially creditable and requires an apportionment between creditable and non-creditable for input tax credit purposes. Although a taxpayer is entitled to select its own apportionment methodology, the Commissioner requires such method to be fair and reasonable in the conditions of the taxpayer's enterprise and should reflect the actual or intended use of the goods or services acquired or imported (ATO, 2020:5-6).

GSTR 2006/4 (ATO, 2020:9-10) states that at the time of acquisition or importation of a good or service, it is the planned use for a creditable purpose that is relevant in calculating a taxpayer's input tax credit. A taxpayer may estimate the planned use of the acquisition or importation based on:

- *records already available from a previous period;*
- *records kept since making the acquisition or importation, but before lodging the Business Activity Statement (BAS) for the tax period in which the acquisition or importation is made, including the actual use (full or partial) of the acquisition;*
- *records kept for some other purpose, for example, income tax, management accounting, profitability analysis, intra-entity transfer charging or cost accounting;*
- *previous experience concerning the usage of similar acquisitions;*
- *business plan; or*
- *any other fair and reasonable basis.*

GSTR 2006/4 (ATO, 2020:24) also includes both direct and indirect apportionment methods. The Commissioner is of the view that where a direct apportionment method is applicable to a taxpayer's enterprise, such method would be most appropriate and best reflect the actual use of acquisitions and importations. However, there is no obligation on taxpayers to use such method. Direct methods strive to identify a direct measure of the use of the acquisition or importation. Measures based on integral features, or elements related to the acquisition, normally provide a

fair reflection of the use thereof. These aspects indicate a direct relationship between the acquisition or importation and its use, for example distance, time, and volume. Conversely, indirect methods are based on the anticipated usage of acquisitions and importations for creditable purposes (ATO, 2020:25). Consideration is given to factors that are not directly identifiable with the use of the specific acquisition. This measure may therefore not give a perfect result but may provide a vendor with a reasonable basis when calculating their input tax credits.

Consequently, there is no apportionment method provided to taxpayers, but taxpayers are rather given autonomy on the appropriate apportionment method to use, as long as it gives equitable results. Some common methods applied by taxpayers to apportion input tax include the time spent, transaction count, floor space, input tax and revenue methods (ATO, 2023c). Taxpayers will therefore be able to apply a method perfectly suitable and accurate for their business operations. This creates a sense of neutrality in the tax system since taxpayers will be able to claim the maximum amount of input tax credits rightfully due to them. However, taxpayers will inherently attempt to claim the maximum amount of input credits that is fair and reasonable in their circumstances. Subsequently, taxpayers may involve experts such as tax practitioners to assist them in determining a ratio that achieves exactly this. Therefore, taxpayers may bestow socially wasteful efforts to restructure the form or substance of their activities in an attempt to reduce their tax liability, which in turn distorts the neutrality of the tax since business decisions are influenced by tax considerations.

Nevertheless, taxpayers are urged to sufficiently document the reasons for the apportionment method applied and why it is viewed as being fair and reasonable, as this will reduce the risk of a possible investigation or dispute with the ATO (ATO, 2023c). It may be necessary to consider whether the tax complies to the principle of administrative ease since taxpayers being encumbered with such extensive administrative obligations might bring this principle into question. Furthermore, the tax authority may be burdened with substantial compliance costs in order to effectively monitor compliance with the law. Therefore, it seems as if this system does not minimize the administrative burden and compliance costs of its stakeholders.

The methodology to be applied in cases where apportionment of expenditure is necessary were considered by the High Court of Australia in the case *Ronpibon Tin NL v. FC of T* (1949). This case sets out the two types of expenditure that requires apportionment and emphasises the importance of considering the facts and circumstances of each individual case when apportioning expenditure, irrespective for which purpose.

In this case, the taxpayer's principal business activities were interrupted by World War II and consequently the court considered what part of administrative and management expenditure incurred by the taxpayer related to the production of assessable income. The allocation of distinct expenditure to precise activities as well as the apportionment thereof was considered by the court. The court subsequently stated the following:

In applying the foregoing test or standard separate and distinct items of expenditure should be dealt with specifically. To begin with there are the payments by Ronpibon Tin No Liability to the dependents of members of that company's Eastern staff... from the point of view of the income-tax law they could not be regarded as business expenditure...

In the next place the cost incurred by the same company in cables and other communications with reference to the buffer stock scheme cannot be deducted... Sufficient details do not appear to say what other distinct and severable items are wholly incapable of reference to the gaining of assessable income.

The charges for management and the directors' fees are entire sums which probably cannot be dissected. But the provision contained in section 51(1) of the ITAA 1936, as has already been said, contemplates apportionment.

Considering the facts in the above-mentioned case, the court remarked that there are two kinds of expenditure that requires apportionment. The first kind relates to expenditure in respect of goods or services that are distinct and of which severable parts are devoted to producing assessable income, while other distinct parts are used for another cause. In cases such as these, it may be possible to divide the expenditure in accordance with the applications which have been made of the goods or services. The second kind of expenditure that should be apportioned relates to those involving a single outlay or charge which serves both purposes indifferently. The latter requires a fair and reasonable assessment of the extent of the relation of the cost to assessable income. The High Court of Australia, in the case of *Ronpibon Tin NL v. FC of T* (1949), thereby emphasised the importance of considering the facts of each individual case where apportionment is necessary. In terms of expenditure for GST purposes, the taxpayer will be required to apportion those expenditures incurred and applied to make both taxable and non-taxable supplies but that is not distinct and easily separable.

Consequently, the most important principle of apportioning GST is that the method elected by a taxpayer to apportion acquisitions between creditable and non-creditable purposes should be fair

and reasonable, truly reflect the planned use, and be suitably documented by considering the facts and circumstances of the specific case (ATO, 2023c).

4.4 Comparing the apportionment methodology of South Africa and Australia

The apportionment methodology of the South African VAT system and the Australian GST system is compared based on the principles of a good tax system as discussed in Chapter 2.

4.4.1 Neutrality

The South African VAT and the Australian GST systems allow a taxpayer to claim input tax deductions on the inputs acquired to make taxable supplies. Since the ultimate purpose of a value-added tax is to tax the final consumer instead of the business, the input tax deductions enhance the neutrality of the aforementioned systems.

The main focus of this study is on the apportionment of these input tax deductions where the goods or services are acquired for mixed purposes. South Africa and Australia follow very different approaches when it comes to their apportionment methodology relating to mixed purpose acquisitions. South Africa has a single, pre-approved apportionment method that must be used by all vendors, unless they apply to SARS to approve the use of an alternative method. In contrast, Australia does not oblige taxpayers to use any specific method and allows taxpayers to choose their own method by giving them certain guidelines.

Neutrality in terms of VAT (or GST) is, to a large extent, achieved by ensuring that the tax burden does not rest with intermediaries in the supply chain (OECD, 2011:6). The Australian GST apportionment system may achieve a more neutral outcome in this regard since taxpayers can apply a method that can accurately determine the input tax credits claimable, without having to wait for approval from the tax authority. This enables taxpayers to claim the maximum input credits rightfully due to them from the start. However, from the perspective of the fiscus, this apportionment methodology may not be as efficient. The Australian Taxation Office states that they accept the fact that taxpayers will seek to claim the maximum amount of GST credits that are fairly and reasonably claimable, while reasonably minimizing the cost of calculating such amounts (ATO, 2023c). It is however inevitable that some taxpayers will apply an apportionment method most beneficial to their business and not necessarily one that is fair and reasonable from both their own and the tax authority's perspective. Consequently, the fiscus is at risk of taxpayers claiming more input tax than acceptable. The Australian Taxation Office attempts to prevent this from occurring by providing taxpayers with guidelines on how to achieve fair and reasonable apportionment results and by requiring taxpayers to keep all evidence to justify their

apportionment methodology. However, these non-enforceable guidelines may not be sufficient in protecting the fiscus from lost GST revenue. The ATO may therefore be exposed to a loss of tax revenue since the apportionment system has insufficient controls in place to ensure that taxpayers claim the correct amount of input tax.

The apportionment methodology applied in South Africa may realise fewer neutral outcomes for taxpayers since the only prescribed method available is accused of giving inaccurate results in certain cases. Furthermore, taxpayers must get approval from SARS to use an alternative method by applying for a VAT ruling. Taxpayers who fail to apply timeously for an alternative apportionment ratio, or who fail to apply timeously for the renewal of their previously approved but now expired ratio within the time frame allowed, will be forced to apply the STB method for the entire year of assessment due to proviso (iii) to section 17(1) prohibiting retrospective application. As a result, the taxpayer may be deprived of significant input tax deductions since the turnover-based method is seldom a fair representation of a vendor's tax application (Badenhorst, 2021). However, this method protects SARS against lost VAT revenue since taxpayers will not be able to claim more input tax than is reasonable within a specific circumstance. Where a taxpayer is unsatisfied with the STB method's result, approval from SARS is required before any other method can be applied.

However, both apportionment systems may result in taxpayers having to incur substantial compliance costs in order to find a method most appropriate to their business operations which will enable the taxpayer to claim the maximum input credits rightfully due to them. VAT vendors may appoint tax practitioners to assist them in determining a method that will most accurately determine the appropriate and most beneficial apportionment method. Consequently, the design of these apportionment systems may impact the spending and business decisions of taxpayers, thereby possibly distorting the neutrality principle (Chen, 2018:33).

4.4.2 Certainty

As mentioned in Chapter 2, uncertainty in a tax setting can arise when the calculation of a tax liability is influenced by subjective conditions. The apportionment methodology of the Australian GST system can present taxpayers with high levels of uncertainty since this methodology contains subjective conditions. Australia gives taxpayers full autonomy on the apportionment of their input tax, and although the Australian tax authority provides extensive guidance to taxpayers on the apportionment of input tax in the goods and services tax ruling (GSTR) 2006/4 through detailed explanations, recommendations, and examples, it remains the responsibility of the taxpayer to determine the ratio that will fairly and reasonably present their tax application. Therefore,

uncertainty can arise amongst taxpayers on what the most appropriate method of apportionment is.

The South African apportionment system may provide taxpayers with more certainty. BGR 16 was published by SARS to provide taxpayers with a detailed explanation on how to apply the standard turnover-based method. This ruling sets out the pre-approved method with a detailed explanation of the components of the ratio. Although this method does not always give neutral results, it does provide taxpayers with a standard ratio. Furthermore, alternative methods must be approved by SARS before the taxpayer can use it in their enterprise (SARS, 2022a:65). Therefore, taxpayers can be certain that their apportionment ratio is regarded as being fair and reasonable if it is in accordance with SARS. However, in some instances the application of the prescribed STB method may present taxpayers with some uncertainty. This statement is supported by Smit (2009:1-2) claiming that uncertainty exists under taxpayers with regard to the application of the turnover-based method. He explains that taxpayers are doubtful as to which income or revenue amounts should be included when calculating the total supplies amount in the apportionment calculation (denominator). Furthermore, Smit (2009:7) is of the opinion that most textbooks only focus on providing general information on apportionment, while only a few give a proper indication of how the methods should be applied and the effect of this application. In addition to this, the uncertainty of taxpayers is also evident from the recent court cases as discussed in Chapter 3 namely *Mukuru Africa (Pty) Ltd v CSARS* (2021) and *CSARS v Tourvest Financial Services* (2021). These taxpayers were required to pay substantial amounts of VAT as a result of incorrectly interpreting the VAT Act.

4.4.3 Fairness and equity

As mentioned previously, both the South African VAT and Australian GST systems allow taxpayers an input tax deduction for inputs acquired to make taxable supplies. This principle intends to ensure that the tax achieves a fair outcome for taxpayers, since VAT is a consumption tax and suppliers should not bear the cost thereof (Famulska & Rogowska-Rajda, 2018:88). Furthermore, both systems exclude certain items from the tax base through either a zero-rating (referred to as GST-free in Australia) or exemption (referred to input taxed in Australia). These exclusions enhance the fairness of the tax for taxpayers in different income classes (Đorđević, 2015:38).

4.4.4 Transparency

When considering the transparency of the tax systems, neither of the systems are fully transparent. Under the South African VAT system, a VAT ruling approving an alternative

apportionment method is issued to an applicant upon successful application. The VAT ruling is issued to the applicant alone and is not made available to the general public if the applicant to which the ruling is issued do not give SARS consent to publish the ruling. As mentioned in Chapter 2, a key element of transparency includes the disclosure and publication of quantitative and qualitative data to allow taxpayers to assess whether the taxes they are paying are fair in relation to other taxpayers (GIFT, 2022:4). The fact that third party taxpayers may not have access to VAT rulings issued to other vendors calls the transparency of this apportionment system into question.

Furthermore, transparency involves paying the right amount of taxes to the tax authority. The Australian government does not prescribe a specific apportionment method and trusts that taxpayers will apportion their input tax credits on a fair and reasonable basis by giving them guidance on what constitutes fair and reasonable and requiring extensive supporting documentation. However, these non-enforceable guidelines may not be sufficient to ensure that vendors claim reasonable input tax credits. In cases where vendors claim excessive amounts of input tax, the apportionment system may fail to be transparent.

4.4.5 Administrative ease

Both the South African and Australian apportionment systems may result in an administrative burden and undue compliance costs for both the taxpayers and the tax authority of the respective countries. South African VAT vendors are required to follow a comprehensive VAT ruling application process to obtain approval for an alternative apportionment method. In the Australian GST system, taxpayers are required to keep detailed documentation on how their apportionment ratio is calculated and the rationale behind the ratio (ATO, 2023c). From a taxpayer's viewpoint these requirements are probably not welcomed since the time, effort, and cost to meet these requirements could possibly have been utilised in a more valuable manner.

From the viewpoint of both the South African and Australian tax authorities, the same argument may hold. Both authorities have to appoint sufficient staff and acquire appropriate resources to deal with the above-mentioned matters. SARS requires skilled employees to manage the application process and subsequently issue VAT rulings to applicants. Similarly, the ATO requires knowledgeable personnel to effectively monitor compliance with the law. The apportionment systems therefore do not adhere to the principle of administrative ease in this regard.

4.5 Chapter conclusion

A detailed discussion of the GST system implemented in Australia enabled a comparison to be drawn between the GST system implemented in Australia with the VAT system applied in South Africa, with a specific focus on the apportionment methodology and approval thereof. The comparison was made primarily based on the principles of a good tax system as discussed in Chapter 2. This comparison revealed that neither of the apportionment systems implemented in these two countries are optimal when comparing them in the light of the principles of a good tax system. The findings are as follows:

a) Neutrality

The Australian apportionment system may erode neutrality for both the taxpayer and the fiscus due to taxpayers possibly having to incur substantial compliance costs to find an apportionment method most appropriate to their business operations, while the fiscus may be exposed to a loss of tax revenue due to insufficient controls implemented to ensure taxpayers claim fair and reasonable inputs. The South African apportionment system may achieve more neutral outcomes for the fiscus in the sense that the current apportionment system protects their interests by requiring taxpayers to apportion their inputs using a pre-approved method or alternatively apply for a different method which has to first be approved before it can be applied. However, the apportionment system may achieve a less neutral outcome for some taxpayers, since the pre-approved method is accused of giving inaccurate results in certain cases, resulting in taxpayers potentially incurring substantial compliance costs to apply for an alternative method.

b) Certainty

Australian taxpayers are responsible to determine an apportionment ratio most applicable to their business operations and consequently, uncertainty may arise amongst taxpayers on what the most appropriate method of apportionment is. South African VAT vendors are presented with more certainty in this regard, as they can either use the prescribed STB method or apply for a different method to be approved by SARS.

c) Fairness and equity

Both the Australian and South African systems exclude certain items from the tax base through either a zero-rating (referred to as GST-free in Australia) or an exemption (referred to as input taxed in Australia). These exclusions may enhance the fairness of the tax for taxpayers in different income classes.

d) Transparency

The Australian apportionment system may lack transparency in the sense that taxpayers may not pay the right amount of taxes to the tax authority when using apportionment

methods that are not fair and reasonable from the fiscus' perspective. The transparency of the South African apportionment system is also brought into question when third party taxpayers do not have access to VAT rulings issued to other vendors.

e) Administrative ease

Both countries' apportionment systems may cause an administrative burden to both the taxpayer and the tax authority. South African taxpayers applying for an alternative apportionment method are required to follow an intensive administrative process, while Australian taxpayers are required to keep detailed documentation supporting their chosen apportionment method. Additionally, the tax authorities of both countries must appoint sufficient staff and acquire appropriate resources to deal with the above-mentioned matters, thereby possibly distorting the principle of administrative ease.

Based on the comparison as outlined above, neither of the apportionment systems are optimal when comparing them in the light of the principles of a good tax system. Each system has its advantages and disadvantages. Therefore, it comes down to which system balances the interests of the taxpayer and the interest of the fiscus the best, rather than to prove the single most optimal system.

5 Chapter 5 Detailed analysis of New Zealand's GST system

In this chapter, a detailed analysis of the GST system implemented in New Zealand is performed. This chapter focusses on the country's GST background, registration requirements, input credits, and apportionment methodology as it relates to input tax credits. Subsequently, a comparison between the GST system implemented in New Zealand and the VAT system of South Africa is made with an emphasis on the input tax apportionment methodology implemented in each country. This detailed analysis allows for an appropriate comparison when considering the principles of a good tax system as discussed in Chapter 2.

5.1 Background and functioning of the New Zealand GST system

GST was introduced in New Zealand on 1 October 1986 at a rate of 10% as a replacement for wholesale sales tax (WST) (Janse van Rensburg, 2011:42). This tax was implemented as part of a series of tax reforms designed to make the tax system more reasonable and effective by decreasing tax rates and broadening the tax base (Benge *et al.*, 2013:485). The rate was subsequently increased to 12.5% in 1989 and then again to the current rate of 15% in October 2010. The imposition of the goods and services tax is set out in section 8 of the *Goods and Services Tax Act 141 of 1985* (hereafter referred to as the GST Act) and reads as follows:

- (1) Subject to this Act, a tax, to be known as goods and services tax, shall be charged in accordance with the provisions of this Act at the rate of 15% on the supply (but not including an exempt supply) in New Zealand of goods and services, on or after 1 October 1986, by a registered person in the course or furtherance of a taxable activity carried on by that person, by reference to the value of that supply.*
- (2) For the purposes of this Act, goods and services shall be deemed to be supplied in New Zealand if the supplier is resident in New Zealand and shall be deemed to be supplied outside New Zealand if the supplier is a non-resident.*

GST can accordingly be defined as a consumption type value-added tax that taxes almost all transactions in New Zealand at an even rate of 15%. The GST system follows the destination principle and therefore imports are subject to GST while exports are zero-rated (Grimmond, 2013).

A registered person, as referred to in section 8, means any person who is registered or is liable to register for GST under this GST Act. A liability to register for GST arises when a person's

taxable supplies exceed NZ\$60 000 per year in New Zealand. However, any person can register voluntarily provided they carry on a taxable activity (IRD, 2021b). A taxable activity is defined in section 6 of the GST Act as follows:

a) any activity which is carried on continuously or regularly by any person, whether or not for a pecuniary profit, and involves or is intended to involve, in whole or in part, the supply of goods and services to any other person for a consideration; and includes any such activity carried on in the form of a business, trade, manufacture, profession, vocation, association, or club:

(b) without limiting the generality of paragraph (a), the activities of any public authority or any local authority or public purpose Crown-controlled company.

In summary, a taxable activity is a continuous or consistent activity under which goods or services are supplied, or are intended to be supplied, in exchange for consideration and includes non-profit activities. It should also be noted that the GST Act deems anything done in connection with the commencement or ending of a taxable activity, including the premature ending of a taxable activity, to be conducted in the furtherance of said taxable activity. However, section 6(3) of the GST Act also specifically excludes certain transactions from a taxable activity. These exclusions include anything done for private recreational purposes or hobbies, any engagement, occupation, or employment under any contract of service or as a director of a company subject to subsection (4) of section 6, any activity as so far it relates to the making of exempt supplies and others.

Unlike most countries, New Zealand has a very broad tax base for GST which includes all food, health, education, local authority rates and government charges, but exempts financial services and residential accommodation (Benge *et al.*, 2013:480). The rationale behind this broad tax base is to allow for lower tax rates, thereby reducing the costs associated with the tax. Furthermore, a broad base, accompanied by lower rates, reduces bias between various types of savings (Marriott, 2016:75). As discussed in Chapter 2, a broad tax base that is taxed at a lower rate contributes to the neutrality of a tax system and therefore this feature makes GST in New Zealand more neutral to taxpayers. Moreover, this consumption tax is levied on the credit invoice basis which is in line with most other countries (Benge *et al.*, 2013:481). Taxpayers registered for GST are obliged to levy this tax on their local supplies. Section 5 of the GST Act states that a supply, for purposes of this Act, refers to all forms of supply.

According to data from the OECD (2022b:2), New Zealand's highest share of tax revenue is derived from personal income tax, which constitutes 38.6% of all tax revenue collected by the fiscus for the 2020 year of assessment. Goods and services tax represents the second-highest

revenue source, making up 31.3% of the total tax revenue, while corporate income tax lies third at 14%. The total tax revenue for the 2020 year amounted to NZ\$109 billion. It is therefore clear that GST is an important revenue source for the New Zealand tax authority as it makes up a large portion of the funds available for government expenditure.

5.2 Amendments to the GST Act

The GST system was accused of creating unintended consequences or undue compliance costs for GST registered taxpayers. According to Baker Tilly Staples Rodway (2022), the rules were challenging to navigate, often created absurd results, and ultimately resulted in significant compliance costs for little benefit to either taxpayers or the government. Consequently, the Inland Revenue Department (IRD) aimed to rectify these issues by adjusting the system to simplify the rules (Bullock *et al.*, 2022). On 8 September 2022, the Taxation (Annual Rates for 2022-23, Platform Economy, and Remedial Matters) Bill (No 2) was introduced and made available for the House to consider (Parker, 2023). The first reading took place on the 21st of September 2022. Since then, several amendments to the GST Act have been made and was included in the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2). On 1 March 2023, the bill was reported back to Parliament and subsequently enacted on 31 March 2023 following an examination by the Finance and Expenditure Committee. The Finance and Expenditure Committee recommended that the bill be passed, and all amendments were accordingly endorsed by the committee (IRD, 2023c). The objective of the changes is to reduce the compliance costs for GST-registered businesses (Bullock *et al.*, 2022). The amendments are set to have different application dates. Some amendments have retrospective application (to 1 April 2011 and 30 June 2014), while some apply from the date of enactment (April 2023), and others apply from 1 April 2024. The relevant amendments are discussed below.

5.3 Input tax credits

As mentioned, GST registered suppliers are obliged to levy output tax on the supply of goods or services. However, these taxpayers are also allowed to claim input credits for the tax paid on the inputs acquired that are necessary to carry on their taxable activity (IRD, 2023a). Input tax is defined in section 3A of the GST Act as:

a) tax charged under section 8(1) on a supply of goods or services acquired by the person:

(b) tax levied under section 12(1) on goods entered for home consumption under the Customs and Excise Act 2018 by the person:

(c) an amount determined under subsection (3) after applying subsection (2).

This section also makes provision for the supply of second-hand goods. Accordingly, the section continues by stating in section 3A(2):

In the case of a supply by way of sale to a registered person of secondhand goods situated in New Zealand, the amount of input tax is determined under subsection (3) if—

(a) the supply is not a taxable supply; and

(ab) the supply is not of goods that—

(i) were acquired before 1 October 1986 by the registered person or by a person who, when acquiring the goods, is an associated person of the registered person; and

(ii) have not been owned, on or after 1 October 1986, by a person who, at the time, is not the registered person and not an associated person of the registered person; and

(b) the supply is not—

(i) a supply of goods previously supplied to a registered person who has entered them for home consumption under the Customs and Excise Act 2018, whether the person is registered at the time they enter the goods for home consumption or later; and

(ii) a supply of goods made by a non-resident, whether or not they made the earlier supply referred to in subparagraph (i); and

(c) the goods acquired by the person for making taxable supplies are either—

(i) not charged with tax at the rate of 0% under section 11A(1)(q) or (r); or

(ii) charged with tax at the rate of 0% under section 11A(1)(q) or (r) and, before the acquisition, have never been owned or used by the person or an associated person.

In essence, GST registered persons can claim an input credit when they purchase second-hand goods, subject to the conditions set out in the GST Act as listed above. However, taxpayers that

want to make such input claims are required to keep detailed documentation and record the name and address of the supplier, the date of purchase, a description of the goods, and the quantity and the price paid for the second-hand goods. Furthermore, such a claim is only allowed to the extent of payment made by the taxpayer for the goods (IRD, 2023b).

A major adjustment was made to section 20(2) of the GST Act, whereby the entire subsection was replaced. Section 20 deals with the calculation of tax payable, thereby addressing both the output tax and especially input tax requirements. Before these amendments were made, section 20(2) regulated the principle that a taxpayer will only be allowed an input tax credit on the condition that an appropriate tax invoice, debit note, or credit note can be provided and is held by the GST registered taxpayer making the deduction at the time the return for that specific supply is submitted, subject to some exclusions. Section 20(2), before its amendment, read as follows:

Notwithstanding any other provision in this Act, no deduction of input tax and no deduction calculated under section 25(2)(b) or (5) shall be made in respect of a supply, unless—

- (a) a tax invoice or debit note or credit note, in relation to that supply, has been provided in accordance with sections 24, 24BA, and 25 and is held by the registered person making that deduction at the time that any return in respect of that supply is furnished; or*
- (b) a tax invoice is not required to be issued pursuant to section 24(5) or section 24(6), or a debit note or credit note is not required to be issued pursuant to section 25; or*
- (c) sufficient records are maintained as required pursuant to section 24(7) where the supply is a supply of secondhand goods to which that section relates; or*
- (d) the supply is a supply of goods or services that is treated by section 5B as being made by the recipient and the recipient has accounted for the output tax charged in respect of the supply; or*
- (e) the supply is a supply of goods and services that is treated as made under section 60B to a nominated person and that person maintains sufficient records as required by section 24(7B):*

provided that where a tax invoice or debit note or credit note in relation to that supply has been provided in accordance with this Act, the Commissioner may determine that no deduction for input tax in relation to that supply shall be made unless that tax

invoice or debit note or credit note is retained in accordance with the provisions of section 75.

The section was however amended and applies to taxable periods starting on or after 1 April 2023. The revised section 20(2) stipulates the circumstances in which a taxpayer is allowed to claim input tax credits. The current section 20(2) reads as follows:

A registered person, when including an amount for a supply of goods or services as a deduction in a calculation of an amount of tax payable by the registered person, must,—

(a) for a supply, meet the requirements of section 19F; and

(b) for a supply that a registered person intends to claim a deduction for under section 20(3) because of an adjustment made under section 25(2)(b) to correct an inaccuracy, provided supply correction information if required by section 19N; and

(c) for a supply, other than a taxable supply, of secondhand goods, meet the requirements of section 19H; and

(d) for a supply that the registered person treats as being within section 5B, have a record of the supply showing that—

(i) the supply meets the requirements for treatment under section 5B as being made by the registered person; and

(ii) the registered person accounts for the output tax charged for the supply; and

(e) for a supply that the registered person treats as being made to the registered person as a nominated person under section 60B, have a record of the supply showing that—

(i) the registered person is nominated to be the recipient of the supply by another person (the nominator) under a contract with the supplier to which the registered person is not a party; and

(ii) the nominator and the registered person agree that the supply is to be treated as being made to the registered person and record the agreement; and

(iii) the registered person pays to the supplier the full consideration for the supply.

This section essentially lists the requirements a taxpayer must meet, in various circumstances, in order to claim an input tax deduction against the total output tax liability due to the fiscus.

Section 20(2) therefore transitioned from establishing the exceptions in which a taxpayer would have been allowed to claim an input tax deduction, to clarifying the circumstances in which input tax can be claimed, provided the requirements are met. When considering the principles of a good tax system as discussed in Chapter 2, the amendment contributes to the neutrality of taxes since this section reduces the time required to understand the exclusions by providing more clear qualifying requirements. In addition, this section also enhances the clarity of the legislation and its requirements by being more specific.

Furthermore, section 20(3C) of the GST Act limits the input tax deduction to only those inputs acquired with the purpose of making taxable supplies. Prior to amendment the section merely stated that:

For the purposes of subsection (3), and if subsections (3D) or (3L) do not apply,—

(a) input tax as defined in section 3A(1)(a) or (c) may be deducted to the extent to which the goods or services are used for, or are available for use in, making taxable supplies:

(b) input tax as defined in section 3A(1)(b) may be deducted to the extent to which the goods are used for, or are available for use in, making taxable supplies other than—

(i) the delivery of the goods to a person in New Zealand:

(ii) arranging or making easier the delivery of the goods to a person in New Zealand.

However, this section was expanded (effective from 1 April 2023) by adding subsection 3(CB) to subsection 3(CH) to section 20(3C). These subsections add limitations to circumstances where input tax can be deducted by vendors and therefore enhances protection for the fiscus against unreasonable input tax claims by vendors. The amended section 20(3C) reads as follows:

(3C) For the purposes of subsection (3), and if subsections (3CB), (3CC), (3D), (3L), or (3LB) do not apply, —

(a) input tax as defined in section 3A(1)(a) or (c) may be deducted to the extent to which the goods or services are used for, or intended to be used in, making taxable supplies:

(b) input tax as defined in section 3A(1)(b) may be deducted to the extent to which the goods are used for, or intended to be used in, making taxable supplies other than—

(i) the delivery of the goods to a person in New Zealand:

(ii) arranging or making easier the delivery of the goods to a person in New Zealand.

(3CB) A registered person, other than a person who has agreed an apportionment method with the Commissioner under section 20(3E), 20(3EB), 21(4), or 21(4B), who acquired goods and services for \$10,000, excluding GST, or less, may not deduct input tax for those goods and services unless subsection (3CC) applies.

(3CC) A registered person referred to in subsection (3CB) may deduct input tax if they acquired the goods and services for the principal purpose of making taxable supplies.

(3CD) A person to whom subsection (3CC) applies may not apportion input tax for an adjustment period, for the goods and services, between taxable and non-taxable use.

(3CE) For the purposes of subsection (3CC) a registered person may not deduct input tax as defined in section 3A(1)(b) if—

(a) for a registered person that is a resident, the goods or services are used for making taxable supplies that are the delivery, or arranging or making easier, the delivery of goods to a person in New Zealand; or

(b) for a registered person that is a non-resident, the input tax is for imported goods of the type referred to in section 20(3LC).

(3CF) For the purposes of subsection (3CC) all supplies made by a non-resident are treated as if they were made and received in New Zealand.

(3CG) A person may elect not to apply subsections (3CB) and (3CC) if they—

(a) opt-out from applying the subsections for at least 24 consecutive months from the date they first opt-out:

(b) apply an apportionment method that is agreed between the Commissioner and an industry association of which the person is a member:

(c) apply an apportionment method that is available to them in a publication by the Commissioner.

(3CH) A person who makes an election under subsection (3CG) must apply subsection (3CG) to all goods and services acquired by them.

In summary, the GST Act provides that a purchaser will only be able to deduct input tax on the acquisition of goods and services to the extent it is used for, or intended to be used in, making taxable supplies (IRD, 2023a). Therefore, GST credits can only be claimed on those goods or services that are used by the taxpayer in their taxable activity with the purpose to make taxable supplies. It is thus self-explanatory that input credits will not be claimable on the making of exempt supplies, since exempt supplies are specifically excluded from a taxable activity as discussed previously.

The allowable input credits can subsequently be offset from the output tax levied on the supply of goods or services made by the taxpayer (IRD, 2023a). Alternatively, in terms of section 20(3)(5), the taxpayer will be refunded in instances where the input credits exceed the output tax levied. The net result is a tax on final consumption (Benge *et al.*, 2013:481). As with all other value-added taxes, this concept enhances the neutrality of the tax since the business does not carry the ultimate tax burden.

5.4 Apportionment of New Zealand's GST

As mentioned above, any taxpayer that makes supplies, relating to both taxable activities and non-taxable activities, is only allowed to claim input credits on those supplies relating to a taxable activity. Consequently, a taxpayer acquiring goods or services to be used partially for taxable purposes and partially for private or exempt purposes (a mixed supply), will be required to apportion input tax and will only be allowed to claim the percentage relating to taxable supplies as input credits. Put simply, the taxpayer must apportion the input credits to the extent that it relates to making taxable supplies (IRD, 2023a).

It should however be noted that section 20(3D) releases a GST registered person from apportioning their mixed purpose supplies if the total value of exempt supplies does not exceed the lower of either NZ\$90 000 or 5% of the total consideration for all supplies made during the adjustment period. Section 20(3D) of the GST Act reads as follows:

A registered person who makes both taxable and exempt supplies is not required to apportion input tax for an adjustment period between such supplies if the registered

person has reasonable grounds to believe that the total value of exempt supplies will not exceed the lesser of—

(a) \$90,000:

(b) 5% of the total consideration for all their taxable and exempt supplies for the adjustment period.

When considering the principles of a good tax system as discussed in Chapter 2, this provision can reduce the administrative burden and undue compliance costs for taxpayers in respect of low-value apportionment adjustments.

5.4.1 Apportionment of New Zealand's GST prior to amendments

Where a GST vendor made mixed purpose supplies, section 20(3EB) of the GST Act allowed a registered person to choose any apportionment method, provided it is fair and reasonable and had regard to the tenor of subsections (3C), (3D), and (3G) to (3M), and was either agreed with the Commissioner by the registered person, or agreed with the Commissioner by an industry association, if the method was intended by the Commissioner and the industry association to be available to a person such as the registered person. In making this apportionment, the GST Act required a taxpayer to estimate at acquisition the extent that the good or service will be used for making taxable supplies. This principle is governed by section 20(3G) of the GST Act that states:

In determining the extent to which goods or services are used for making taxable supplies, a person must estimate at the time of acquisition how they intend to use the goods or services, choosing a determination method that provides a fair and reasonable result. The determination is expressed as a percentage of the total use.

The estimated intended taxable use of the goods or services acquired will consequently determine the portion of input tax that may be claimed. Consequently, the taxpayer had full autonomy when deciding how the percentage should be calculated and could refer to past records, business plans or make an estimation based on experience to determine its intended taxable use (IRD, 2023d).

Section 20(3H) of the GST Act sets out the calculation to be used by taxpayers in instances where an apportionment of input tax credits is necessary. The calculation of the input credit would be as follows:

$$\% \text{ intended use} \times \text{full input tax deduction} = \text{allowable input tax deduction}$$

In this equation the full input tax deduction is the total amount of input tax on the supply and the percentage intended use is the extent to which the goods or services are intended to be used by the GST registered person for making taxable supplies, estimated at the time of acquisition under section 20(3G) and expressed as a percentage of total use. As mentioned earlier, this percentage can be based on past records, experience, business plans or another suitable method (IRD, 2023d).

The apportionment calculation was therefore purely based on an estimation of taxable use and the GST Act therefore required taxpayers to subsequently monitor the actual taxable use of all goods or services over adjustment periods. At the end of the adjustment period the GST registered person had to determine whether there is a difference between the percentage actual use and the percentage estimated use of any goods or services acquired to make taxable supplies. Where any difference arises, an adjustment is required (IRD, 2021a). This is discussed in more detail in 5.5 of this study.

However, the IRD noted that the GST apportionment and adjustment rules may have created uncertainty, complexity, unintentional consequences, or unnecessary compliance costs and therefore decided to amend the GST Act (Bullock *et al.*, 2022).

According to Cuthbertson and Mason (2022:5), the GST apportionment and adjustment rules were complicated and had substantial compliance costs due to the taxpayer having to frequently monitor whether any business assets are used for non-taxable purposes and accordingly make adjustments where a change in use occurred. In their opinion, these complexities have potentially resulted in reduced compliance by taxpayers, which is not ideal and erodes the neutrality principle. They suggested that a taxpayer should be able to exclude an asset from the GST scope at acquisition. Therefore, if an asset is not acquired for the primary purpose of making taxable supplies, a registered taxpayer should be able to elect to exclude that asset from their taxable activity. This option would reduce complexity and make it easier for taxpayers to comply with the provisions of the GST Act. This principle will also lead to more certainty, since taxpayers can clarify that no input was claimed on acquisition and consequently no output tax is required on disposal of the excluded asset.

Furthermore, Cuthbertson and Mason (2022:50) suggested that a wider range of approved apportionment methods should be provided by the IRD or alternatively, that a system is implemented whereby the tax authority must publish anonymised approved methods of apportionment, or alternatively provide guidelines as to appropriate approved methods. The aim of this implementation would be to reduce the compliance costs incurred by taxpayers as a result

of them having to monitor whether any of their business assets are used for non-taxable purposes and to make yearly adjustments where a change in use occurred.

When considering the principles of a good tax system as discussed in Chapter 2, the prior GST apportionment rules fell short in many aspects. The apportionment system eroded neutrality and administrative ease since undue compliance costs were created for taxpayers.

5.4.2 Apportionment of New Zealand's GST subsequent to amendments

On 1 April 2023, numerous amendments to the GST apportionment rules took effect. The amendments to the GST apportionment rules were aimed at enhanced flexibility, reduced complexity, and lower compliance costs for taxpayers (Bullock *et al.*, 2023).

One of the key changes to the apportionment rules is the reintroduction of the principal purpose test (Bullock *et al.*, 2022). Under this rule, GST vendors will not be obliged to apportion input tax for goods or services that are used for mixed purposes with a value of NZ\$10 000 or less, i.e., low-value goods or services. Accordingly, in instances where goods or services are acquired with the main purpose of making taxable supplies, any insignificant non-taxable use can be ignored, and a full input tax deduction can be claimed. In contrast, where goods or services are acquired mainly for private use, with a small element of taxable use, no input tax deduction will be claimable (Bullock *et al.*, 2022). Taxpayers that decide to use the principal purpose test for their low-value assets are required to apply this approach to all of its assets costing NZ\$10 000 or less and should continue to do so for at least two years (Bullock *et al.*, 2023). This amendment has the purpose of reducing the administrative burden and compliance costs for taxpayers making GST adjustments for low-value goods or services, thereby enhancing the administrative ease of the tax system. However, it is crucial to consider the long term overall principal purpose of the goods or services acquired, since a mere 50% use test is arbitrary and does not indicate the main purpose of the good or service (Bullock *et al.*, 2022).

Taxpayers are however not obliged to use the principal purpose test and can opt to claim the business percentage of goods and services, using the apportionment method based on the intended taxable use of the good or service. However, if a taxpayer chooses to use the apportionment method instead of the principal purpose method, they need to apportion all low-value goods or services acquired for at least 24 months (IRD, 2023d). The principal purpose test does not apply to taxpayers who have agreed with the IRD on a specific apportionment methodology (Bullock *et al.*, 2022).

Furthermore, the Commissioner is more flexible to approve a bigger range of GST apportionment methodologies on implementation of the new rules. In addition to this, apportionment methodologies, which are considered appropriate for specific industries, are published in order for taxpayers to implement an approved apportionment method without having to engage with the IRD. According to Bullo *et al.* (2023), this provides businesses with more flexibility and reduces compliance costs. Furthermore, increased transparency improves consistency with others in the industry.

The above-mentioned rule is set out in the amended section 20(3EB) of the GST Act. According to this section, a GST vendor is allowed to choose any apportionment method, provided it is fair and reasonable, and is either agreed with the Commissioner by the registered person, or is agreed with the Commissioner by an industry association, if the method is intended by the Commissioner and the industry association to be available to a person such as the registered person, or is published by the Commissioner and available to the person in that publication. The apportionment rules based on the intended taxable use of the good or service (set out in section 20(3G)) that applied previously is therefore still relevant. However, under the amended section 20(3EB), a taxpayer has the option to either apportion their input tax based on the intended use or choose a method from those published by the IRD and considered appropriate for the specific industry. These pre-approved methods reduce compliance costs for taxpayers as a result of them not having to monitor whether any of their business assets are used for non-taxable purposes and to then make yearly adjustments where a change in use occurred (Cuthbertson & Mason, 2022:50). Consequently, the principle of administrative ease is enhanced.

Another fundamental change that took effect from 1 April 2023, is the option for taxpayers to exclude certain capital assets from the GST scope (Bullo *et al.*, 2023). Under this amendment, taxpayers are allowed to exclude certain capital assets from their GST for capital expenditure purposes. This is applicable even if these capital assets are being used to produce GST taxable supplies and incur GST claimable expenditure. Where GST was formerly claimed on a portion of the acquisition price of certain capital assets, the default position upon sale was that a GST liability would arise for the vendor. This resulted in the vendor paying 15% tax on the total selling price, even if GST was only claimed partially on the asset. The amendment therefore prevents GST registered taxpayers from incurring major GST liabilities on the sale of a capital asset where GST has been claimed only partially on the acquisition of certain capital assets in a prior period. However, there is a limited window of opportunity to elect assets to be excluded from GST where those assets were not purchased with the main intention of making taxable supplies. The opportunity ends on 1 April 2025, thereby allowing taxpayers a two-year window to exclude these

assets from their GST scope, after which subsequent sales will be subject to GST (Bullock *et al.*, 2023).

When considering the recommendation made by Cuthbertson and Mason (2022:5) to enable taxpayers to exclude certain assets, that are not used primarily for taxable use, from their GST in order to reduce complexity, this new rule addresses their concerns quite precisely. However, the rule only applies for a two-year period and may therefore not result in a long-term solution. It is therefore clear that even after the amendments have been implemented by the Commissioner, there are still issues in the GST system of New Zealand. This is supported by a statement made by Cuthbertson and Mason (2022:5-6) stating:

In summary, we believe that the proposed changes will address some immediate and present problems with the GST Act... Nevertheless, we believe that the proposals are likely to increase complexity in GST legislation overall... We recommend a comprehensive rewrite of the GST Act, including the apportionment rules in the short to medium term.

Furthermore, Bullock *et al.* (2022) discussed the significant GST apportionment changes on the horizon in 2023 and stated that “the proposed changes are intended to simplify things; however, as is often the case with tax, there will still be complexity under the new rules”.

5.5 Adjustments subsequent to apportionment

Where the apportionment calculation used by taxpayers is based on an estimation of taxable use, the GST Act requires taxpayers to subsequently monitor the actual taxable use of all goods or services over adjustment periods, the number of which depends on the GST-exclusive cost. The GST registered person must, at the end of the adjustment period, determine whether there is a difference between the percentage actual use and the percentage estimated use of any goods or services acquired to make taxable supplies. Where any difference arises, an adjustment is required. This principle is governed by section 21A of the GST Act, stating that:

A registered person must, at the end of an adjustment period,—

(a) identify the percentage actual use of the goods or services in making taxable supplies in the period; and

(b) compare the percentage actual use with percentage intended use or previous actual use, as applicable; and

(c) if a percentage difference arises and section 21(2)(c) or (d) does not apply, make an adjustment for any percentage difference for the adjustment period.

Such an adjustment must be made on the last day of the adjustment period. Section 21C of the GST Act explains how such an adjustment should be made for both the first and subsequent adjustment periods. The first adjustment must be determined by comparing the intended use with the actual use of the goods or services. Subsequently, the actual use of the goods or services must be compared to the previous actual use (i.e., the actual use determined in the previous adjustment period), or the percentage intended use if no adjustment was made in previous adjustment periods. In instances where a percentage difference arises, the adjustment is calculated as follows:

$$\text{full input tax deduction} \times \text{percentage difference}$$

In this equation the full input tax deduction is the total amount of input tax on the supply and the percentage difference means the difference between the percentage actual use and, as applicable, —

- (i) the percentage intended use; or*
- (ii) for a subsequent adjustment period following a period in which a person has made an adjustment, the previous actual use of the goods or services in the earlier period.*

However, section 21(2) of the GST Act states that GST registered persons will not be obliged to make an adjustment, and consequently the above section will not apply if:

(a) section 20(3D) applies to them;

(ab) the person is a non-resident who has incurred input tax as defined in section 3A(1)(b) for goods and who—

- (i) exports the goods in or before the adjustment period; and*
- (ii) disposes of the goods overseas in the adjustment period or holds the goods overseas at the end of the adjustment period:*

(ac) the person has made an adjustment under section 21FB for a change in use of the goods or services and has not changed the use of the goods or services since that change:

(b) the value of the goods or services, excluding GST, is \$10,000 or less:

(c) the difference between the percentage intended use on acquisition and the percentage actual use for the relevant adjustment period is less than 10 percentage points, but this paragraph does not apply if the adjustment amounts to more than \$1,000:

(d) the difference between the previous actual use calculated for the most recent adjustment period in which an adjustment was made and the percentage actual use for the relevant adjustment period is less than 10 percentage points, but this paragraph does not apply if the adjustment amounts to more than \$1,000:

(e) they intend to apply section 6(3)(e) or section 91 to the supply.

It should be noted that paragraph (b) of section 21(2) was amended with effect from 1 April 2023. Originally, the value of goods that were not obliged to be apportioned, excluding GST, was NZ\$5 000 or less. However, in terms of the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2) as discussed by Parker (2023), the value increased to NZ\$10 000 in the newest version of the legislation. This means that GST registered businesses will not have to adjust for input tax credits where goods or services, which have both a taxable and non-taxable element, cost less than NZ\$10 000 (GST-exclusive).

5.6 Comparing the apportionment methodology of South Africa and New Zealand

The apportionment rules of the VAT system implemented in South Africa and the GST system applied in New Zealand are compared on the basis of the principles of a good tax system, as discussed in Chapter 2.

As mentioned, a taxpayer is allowed to claim input tax deductions on the inputs acquired to make taxable supplies under both systems. Therefore, both systems may be viewed as being neutral in this regard since the purpose of the tax, which is to tax final consumption, is fulfilled under this rule (OECD, 2022a). The tax is not meant to influence the business or spending decisions of a taxpayer and consequently taxpayers can offset the VAT incurred to make taxable supplies from their ultimate VAT liability.

The primary focus of this study, however, is on the apportionment of these input tax deductions in instances where the VAT is incurred for both taxable and non-taxable supplies. A comparison is therefore drawn between the South African apportionment methodology and the methodology followed by New Zealand before and after the recent amendments to the legislation of the last-mentioned country.

5.6.1 South Africa and New Zealand prior to amendments

5.6.1.1 Neutrality

Under the South African VAT system, a pre-approved apportionment ratio is provided to taxpayers. Any alternative method must be approved by the Commissioner. New Zealand relied on an entirely different approach whereby taxpayers had to estimate the percentage they intend to use the good or service for taxable purposes and claim accordingly. Adjustments were then subsequently (mostly annually) required for any changes in the percentage taxable use.

In Chapter 2, it was clarified that a neutral tax should not influence the economic decisions of a business and businesses should therefore not be burdened with inappropriate compliance costs that can possibly manipulate their economic decisions. A neutral tax system exercises minimal impact on both the spending and business decisions made by companies and individuals and therefore aims to raise revenue in a manner that minimizes discrimination against a specific economic choice (Chen, 2018:33). Neither of the approaches followed by the two mentioned countries enhances the neutrality of the tax where either of the taxes results in undue compliance costs being incurred by taxpayers as a result of their economic decisions. In South Africa's case, this is mostly because of taxpayers potentially involving third parties, such as tax practitioners, to assist them in determining an apportionment method that best reflects their tax application and that will result in the most beneficial (but legal) outcome, due to the prescribed method rarely being a fair representation. For New Zealand, compliance costs arise due to taxpayers having to bestow additional time, effort, and money to consistently monitor the taxable use of their business assets in order to make adjustments where a change in use occurs.

Furthermore, a broad tax base accompanied by lower tax rates is regarded as being more neutral (Furman, 2008:3). New Zealand's GST system has a broad tax base and includes all food, health, education, local authority rates and government charges, but exempts financial services and residential accommodation. However, GST is taxed at a rate of 15%, the same rate at which VAT is levied in South Africa. However, the South African VAT system provides for many zero-rated and exempt items and therefore has a narrower tax base. Therefore, the broad tax base implemented in New Zealand does not achieve a higher level of neutrality as described by Furman (2008:3) since the rate is too high.

5.6.1.2 Transparency

Transparency includes paying the right amount of taxes to the tax authority, thereby enabling the government to finance and deliver national development plans for the benefit of the community

(BHP, 2022). Firm rules regarding the apportionment of input tax exist within the South African VAT apportionment system. Where a taxpayer is of the opinion that the prescribed STB method is not applicable to their VAT application, pre-approval is required from the Commissioner to use an alternative apportionment method. Furthermore, alternative methods approved by SARS only apply with prospective effect (Jembula, 2020). In this way the fiscus is, to a certain extent, protected from taxpayers claiming unreasonable amounts of input tax that will result in SARS forfeiting significant amounts of tax revenue. However, in instances where applicants deny SARS consent to publish their VAT ruling, transparency is distorted since other taxpayers may be unable to evaluate the taxes paid by taxpayers in similar positions. In the context of the New Zealand GST apportionment system, the fiscus is exposed to a much greater extent of forfeiting tax revenue since apportionment is based on the intended taxable use of the good or service. As mentioned by Cuthbertson and Mason (2022:5) complexities in the GST system as it relates to apportionment methods can potentially result in reduced compliance by taxpayers. Reduced compliance may result in the Commissioner collecting inaccurate amounts of tax revenue, thereby distorting transparency.

5.6.2 South Africa and New Zealand subsequent to amendments

5.6.2.1 Neutrality

The reintroduction of the principal purpose test in the New Zealand GST system has the intention to reduce compliance costs for taxpayers (Bullock *et al.*, 2022). This may be possible since taxpayers are no longer obliged to apportion input tax on low-value goods or services where the taxable or non-taxable use is insignificant. Consequently, the apportionment system may achieve a more neutral outcome since taxpayers are not burdened with inappropriate compliance costs that can possibly manipulate their economic decisions. Although taxpayers will be able to claim full input tax deductions where the non-taxable use of low-value goods or services is insignificant, the IRD's position will remain unchanged since input tax will also not be claimable where the taxable use is insignificant. Furthermore, the fiscus is protected in the sense that vendors electing to use the principal purpose test are obliged to apply this method to all their low-value goods or services for a 24-month period, thereby restricting vendors to use this method only when it is beneficial to them i.e., claiming full input tax where the non-taxable use is insignificant (Bullock *et al.*, 2023). This amendment may result in GST apportionment achieving a more neutral and equitable outcome for both the taxpayer and the fiscus. The South African VAT system does not contain a similar provision. VAT vendors are obliged to apportion input tax on goods or services acquired to make mixed purpose supplies irrespective of their value which therefore possibly results in additional compliance costs being incurred.

Although the above-mentioned implementation may enhance the neutrality of the GST apportionment system in the form of reduced compliance costs resulting from not having to monitor adjustments, it should be considered whether these costs will arise elsewhere. The principal purpose test is applicable where the taxable or non-taxable use is insignificant. However, a mere 50% test is arbitrary and is not indicative of the principal purpose (Bullock *et al.*, 2022). Taxpayers may therefore have to incur additional costs to determine the principal purpose of these low-value goods and services and the neutrality (and administrative ease) of the tax may accordingly be eroded.

Both tax systems do however contain a *de minimis* rule. In the South African VAT system, no apportionment of input tax is required where the taxable use equals or exceeds 95%. In essence, where the non-taxable use is less than 6%, a taxpayer is not required to apportion. Similarly, in New Zealand, a taxpayer is not required to apportion input tax for an adjustment period if the taxpayer has reasonable grounds to believe that the total value of exempt supplies will not exceed the lesser of NZ\$90 000 or 5% of the total consideration for all their taxable and exempt supplies for the adjustment period. The *de minimis* rule is different from the principal purpose test in the sense that it is concerned with the percentage taxable use and not the value of the good or service. This rule prevents taxpayers from incurring unnecessary compliance costs for insignificant amounts of VAT relating to non-taxable use and therefore enhances the neutrality (and administrative ease) of both these apportionment systems.

5.6.2.2 Certainty and simplicity

The fundamental amendment implemented by the IRD, allowing GST vendors to exclude certain capital assets from their GST scope, can reduce complexity, increase certainty, and make it easier for taxpayers to comply with the provisions of the GST Act since taxpayers can be confident that no input was claimed on acquisition and consequently no output tax is required on disposal of the excluded asset (Cuthbertson & Mason, 2022:5).

The South African VAT system provides taxpayers with certainty in respect of the apportionment method itself. Taxpayers can either apply the pre-approved STB method prescribed by SARS or alternatively, apply for another method to be approved by the Commissioner in instances where the turnover-based method does not yield fair results. Such alternative methods includes, amongst others, methods based on inputs, floor space, transaction count and employee time spent (Jembula, 2020:2).

5.6.2.3 Transparency and fairness

Excluding certain goods from the GST base, as discussed above, may also result in the system being fairer to taxpayers in the sense that they will not incur large amounts of output tax on the disposal of the capital asset that is excluded from the tax base. Furthermore, the OECD (2010:15) states that a less complex tax system can also lead to a higher level of taxpayer compliance. Therefore, from the perspective of the fiscus, reduced complexity and therefore increased compliance by taxpayers may result in them collecting more accurate amounts of tax revenue, thereby contributing to the transparency of the apportionment system. However, this amendment will only apply for a two-year period and may therefore not achieve the desired outcome. In addition, this may be regarded as being unfair towards taxpayers registering as vendors after the two-year period has lapsed, since they will not have the benefit of excluding assets from the GST scope and will incur these output tax liabilities. The South African VAT system does not allow a taxpayer to exclude certain capital assets from the scope of VAT.

The publication by the IRD of approved apportionment methods for specific industries may also contribute to a more transparent GST apportionment system. As discussed in Chapter 2, a principal element of transparency includes the disclosure and publication of quantitative and qualitative data to allow taxpayers to assess whether the taxes they are paying are fair in relation to other taxpayers (GIFT, 2022:4). Therefore, the publication of approved methods by the IRD may make the apportionment system more transparent in certain circumstances. The South African apportionment system may be less transparent in this respect since VAT rulings issued to applicants may not be published or made available for third parties to evaluate if the applicant denies such publication.

5.6.2.4 Administrative ease

The principle of administrative ease, as discussed in Chapter 2, requires a tax system to be easy and inexpensive to administer. As mentioned, the amendments to New Zealand's GST system include the publication of approved apportionment methods for specific industries. Vendors adopting an approved method will therefore not be obliged to monitor the taxable use of their goods or services, thereby making the tax easier to administer. According to Bullock *et al.* (2023), this will provide businesses with more flexibility and reduce compliance costs. This is somewhat similar to the method followed in the South African VAT system. It should however be kept in mind that the IRD will, to a greater extent, be exposed to taxpayers choosing published methods that result in them claiming the maximum amounts of input tax, irrespective of whether it is fair and reasonable from the viewpoint of the fiscus. In the South African VAT system, the Commissioner

has less exposure to such a risk since the current STB method is accused of being in favour of the fiscus (due to the method including all forms of income). In addition, any alternative method requires approval from SARS. However, administrative burdens may arise from the application process for VAT rulings. This application process is administratively intensive and may erode the principle of administrative ease for both the taxpayer and the fiscus.

This comparison reveals that, even after the amendments were implemented in New Zealand's GST system, it remains questionable whether the apportionment system adheres to the principles of a good tax system, as discussed in Chapter 2, in certain circumstances. Most amendments succeed in addressing a particular concern only to create an alternative concern in the process. This is supported by the statement made by Cuthbertson and Mason (2022:5-6) that "the changes will address some immediate and present problems with the GST Act... Nevertheless, we believe that the proposals are likely to increase complexity in GST legislation overall".

5.7 Chapter conclusion

The detailed analysis of the GST system implemented in New Zealand permitted for a comparison to be made between the GST system implemented in New Zealand with the VAT system applied in South Africa, with a specific focus on the apportionment methodology and approval thereof. This comparison was made primarily based on the principles of a good tax system as discussed in Chapter 2. This discussion revealed that neither the VAT nor the GST system implemented in South Africa and New Zealand, respectively, is ideal when comparing them in the light of the principles of a good tax system, as both systems indicate areas of concern under the aforementioned principles. The findings are as follows:

a) Neutrality

The GST apportionment system may result in non-neutral outcomes for the taxpayer when having to bestow additional time, effort, and money to consistently monitor the taxable use of business assets and to make adjustments where a change in use occurs. Although the reintroduction of the principal purpose test may alleviate some of these efforts, the test only applies to low-value goods and services and therefore does not eliminate the issue. The South African VAT apportionment system may achieve a neutral outcome for the fiscus considering that the current apportionment system protects their interests by requiring taxpayers to apportion their inputs using a pre-approved method or apply for a different method. However, the pre-approved method is accused of giving inaccurate results in certain cases, resulting in taxpayers possibly incurring substantial costs to apply

for an alternative method and thereby leading to less neutral outcomes for some taxpayers.

b) Certainty and simplicity

The amendment implemented by the IRD allowing GST vendors to exclude certain capital assets from their GST scope may reduce complexity and increase certainty for taxpayers since no apportionment is required on assets excluded from the GST scope. However, the provision is for a limited period and will therefore not yield long-term benefits. South African VAT vendors can choose between the SARS prescribed STB method or applying for an alternative method and therefore experience a high level of certainty as it relates to apportionment methods.

c) Transparency and fairness

The publication of approved methods by the IRD may make the apportionment system more transparent as it is accessible to all taxpayers. Furthermore, the option to elect assets to be excluded from the GST scope can reduce complexity and possibly increase compliance by taxpayers, resulting in the fiscus receiving more accurate amounts of tax revenue and thereby contributing to the transparency and fairness of the tax. The South African apportionment system ensures, to a large extent, that the fiscus is protected from a loss in tax revenue. However, in instances where VAT rulings are not made available to the wider public, the transparency of the apportionment system may be brought into question.

d) Administrative ease

The time and costs incurred to monitor the taxable use of goods or services is eliminated where GST vendors elect to use an approved and published apportionment method, thereby making the tax easier and less expensive to administer in such circumstances. Similarly, South African VAT vendors applying the STB method are also freed from any additional administrative burdens. However, an administrative burden arises for South African VAT vendors when applying for a VAT ruling to use an alternative method. This application process is administratively intensive and may erode the principle of administrative ease for both the taxpayer and the fiscus.

Based on the comparison between the two systems, it is evident that neither of the apportionment systems are optimal. Each system has its advantages and disadvantages. Consequently, it comes down to which system strikes the best balances between the interests of the taxpayer and the interest of the fiscus, rather than to prove the single most optimal system.

6 Chapter 6 Conclusion

In this concluding chapter, an overall conclusion is drawn between the VAT (or GST) apportionment systems implemented in South Africa, Australia, and New Zealand in order to address the objectives described in Chapter 1. This chapter endeavours to determine whether South Africa can apply an alternative approval methodology, or elements thereof, that will result in the VAT apportionment system being more practical and uncontentious. Furthermore, the intention of this comparison was to determine whether an alternative apportionment method, or elements thereof, can achieve a more equitable balance between the interests of the taxpayer and that of the fiscus. The principles of a good tax system as discussed in Chapter 2 forms the basis of this comparison.

6.1 Findings on the objectives of this study

The VAT apportionment approval mechanism is considered by some authors to be contentious and impractical in cases where taxpayers have to apply inappropriate apportionment methods, which are not reflective of their tax application, until such time that they are granted approval to use an alternative method. The main objective of this study was to critically compare the apportionment method and basis of approval of the South African VAT system with that of other countries by considering the legislation, publications, and rulings of the different tax systems. This comparison intended to identify alternative approval methods, or elements thereof, that may yield a more equitable balance between the interests of South African taxpayers and the fiscus.

The secondary objectives of this study were therefore:

- To conduct an analysis of the principles of a good tax system, specifically focussing on the principles of neutrality, clarity and simplicity, fairness and equity, transparency, and administrative ease. This theoretical objective was addressed in Chapter 2.
- To conduct an analysis of South Africa's legislation and interpretation notes relevant to VAT apportionment. This theoretical objective was addressed in Chapter 3.
- To compare the goods and services tax systems of Australia and New Zealand with that of South Africa to evaluate it in terms of the principles of a good tax system. This theoretical objective was addressed in Chapter 4 and Chapter 5.

The comparison between these apportionment systems revealed that none of the systems is optimal when evaluating them based on the principles of a good tax system, since each of them lacks compliance with these principles in different aspects. Furthermore, it was of great

significance to note that there is, to a large extent, a trade-off between these principles, either amongst the principles themselves or as to how they affect the taxpayer and the fiscus. For example, the VAT apportionment system implemented in South Africa presents taxpayers with a high level of certainty since taxpayers can either choose to use the STB method prescribed by SARS or apply for a VAT ruling to use a different method. However, the principles of neutrality and administrative ease are consequently negatively affected, since the STB method is accused of frequently providing inaccurate results, thereby causing taxpayers to spend additional time and money to apply for an alternative method. Moreover, the analysis of the South African apportionment system revealed that in many cases the system provides the fiscus with more neutral outcomes than it does for the taxpayer, since the design of the system provides SARS with a high level of protection against a loss of tax revenue, while some taxpayers are forced to use an apportionment method that does not accurately reflect their tax application. However, this trade-off occurs in both the Australian and New Zealand apportionment systems as well.

The Australian GST apportionment system allows taxpayers to choose their apportionment method and may therefore provide taxpayers with relatively neutral outcomes. Nevertheless, the principles of certainty and administrative ease are consequently affected since taxpayers may be unsure as to which method is most appropriate to their business operations, which may result in taxpayers engaging the services of tax practitioners to assist them in making this determination. The ATO also expects taxpayers to keep detailed documentation of their apportionment methods which may cause an administrative burden for taxpayers. In this case, a neutral outcome may be achieved to the detriment of the principles of certainty and administrative ease. Furthermore, although the apportionment system may achieve a neutral outcome for taxpayers, the contrary may be true for the fiscus since they are largely exposed to a loss in tax revenue.

In the GST apportionment system implemented in New Zealand, a trade-off between the principles of neutrality and administrative ease occurs as a result of the reintroduction of the principal purpose test. When applying this test, taxpayers are not obliged to apportion input tax on low-value goods or services where the taxable or non-taxable use is insignificant and accordingly reduces compliance costs. However, a mere 50% test is arbitrary, and taxpayers may therefore have to incur additional time and money to determine the principal purpose of these low-value goods and services, thereby possibly resulting in an administrative burden and additional compliance costs. Furthermore, the option to elect certain capital assets to be excluded from the scope of GST can result in a higher level of certainty and transparency but may be regarded as unfair since this option is only available for two years.

The trade-off between the principles, either amongst the principles themselves or as to how they affect the taxpayer and the fiscus, is consequently clear from the examples mentioned above. It is therefore evident that none of these apportionment systems provide optimal results since none of the apportionment methodologies conform to all the principles of a good tax system regarded as being relevant to a value-added tax. Therefore, it comes down to which system strikes the best balance between the interests of the taxpayer and the interest of the fiscus rather than to prove the single most optimal system.

As discussed in Chapter 2, the guidelines, decisions, and principles that determine the characteristics of a tax system are established by the relevant countries' government. This is also known as the tax policy. These characteristics make it possible to finance public spending and support economic activity in the specific country. Therefore, the apportionment methodology that balances the interests of the taxpayer and the fiscus the best varies for each country by reason of the different tax policies adopted by the tax authorities of the respective countries.

The comparisons in Chapter 4.4 and in Chapter 5.6 revealed that the South African apportionment system achieves a decent balance as it protects the fiscus, to a large degree, against a loss of tax revenue, while allowing taxpayers to apply for alternative approval methods where the prescribed method is not appropriate for their business operations. Although the analysis revealed that this approach can create an additional administrative burden, undue compliance costs, and result in less transparency, the interests of both the fiscus and the taxpayer is protected in the long term and therefore strikes a satisfactory balance between the aforementioned parties.

6.2 Considering the implementation of alternatives in South Africa

This study also considered whether there are any elements of the GST apportionment systems implemented in Australia and New Zealand, respectively, that can make a valuable contribution to the South African VAT apportionment system.

Based on the analysis of the apportionment methods implemented in the above-mentioned countries, one element from the New Zealand apportionment system that may be considered in South Africa is the publication of apportionment methods which are considered appropriate for specific industries. These publications may result in reduced compliance costs for some taxpayers in instances where these methods are reflective of their tax application. However, for the publications to be effective, decent consideration would have to be given as to which apportionment methods will be appropriate for the majority of the industries' taxpayers.

6.3 Potential avenues for future research

This study was based on the provisions of the second issue of BGR 16. Since submission of this mini-dissertation, SARS has amended and published issue three of BGR 16. The third issue of BGR 16 was issued by SARS on 27 November 2023. This issue provides taxpayers with comprehensive guidance on the standard turnover-based method of apportionment. The STB method in both issues is mathematically similar since both methods include taxable supplies in the numerator and all income inclusive of taxable supplies in the denominator. However, the formula of the newly amended issue eliminates eleven items which may make the ratio more favourable. These items include, amongst others, foreign exchange differences that do not form part of any hedging activities, accounting entries such as fair value adjustments, extraordinary income, current account and SARS interest, and manufactured interest and dividends received by the borrower of a securities lending transaction (SARS, 2023c,2-3). In addition to this, the formula makes provision for five adjustments to the value of certain income streams included in the formula (SARS, 2023c,2-3). To assist taxpayers with the interpretation of these exclusions and adjustments relating to the formula, the ruling also includes comprehensive guidance in the form of notes.

The amendments to BGR 16 possibly addresses, amongst others, a lot of the concerns that arose from the second issue and that was discussed in this mini-dissertation. Therefore, the publication of the third issue provides an opportunity to evaluate whether and how the amended BGR 16 addresses the concerns that arose from the second issue. It would be valuable to determine whether the amended BGR provides a better balance between the interest of the taxpayer and the interest of the fiscus as it relates to VAT apportionment.

6.4 Overall conclusion

This detailed analysis of the VAT apportionment system implemented in South Africa and the GST apportionment systems applied in Australia and New Zealand, respectively, allowed for a comparison to be drawn between these various systems. The comparison was, however, based solely on the principles that constitute a good tax system.

This comparison revealed that all three of the systems considered in this study fail to meet all of the principles of a good tax system. It was also noted that there is a trade-off between these principles in each of the systems. Since it became clear that none of the countries' considered in this study has an optimal apportionment system, it came down to which system balances the interest of the taxpayer and the interest of the fiscus the best. It was then remarked that the apportionment methodology that balances these interests the best varies for each country by

reason of the different tax policies adopted by the tax authorities of the respective countries. However, it was concluded that South Africa's VAT apportionment methodology achieves a satisfactory balance since it protects both the interest of the taxpayer and the interest of the fiscus in the long term.

It was then considered whether any elements of the Australian or New Zealand GST apportionment methodologies can be valuable to the South African VAT apportionment system. It was concluded that the publication of apportionment methods which are considered appropriate for specific industries may be valuable to the South African VAT apportionment system.

Lastly, it was acknowledged that BGR 16 was amended since submission of this mini-dissertation. The amended version aimed to address the concerns that arose from the second issue and that was discussed as part of this study. The issue of this amended ruling therefore provides an opportunity to evaluate whether the amended BGR 16 addresses these concerns and whether it creates a better balance between the interest of the taxpayer and the interest of the fiscus as it relates to VAT apportionment.

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