THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Reportable

Case no: 435/2020

In the matter between:

THE COMMISSIONER FOR THE
SOUTH AFRICAN REVENUE SERVICES **APPELLANT**

and

TOURVEST FINANCIAL SERVICES (PTY) LTD **RESPONDENT**

Neutral citation: *Commissioner for the South African Revenue Services v Tourvest Financial Services (Pty) Ltd* (Case no 435/2020) [2021] ZASCA 61 (25 May 2021)

Coram: PONNAN, MBHA and SCHIPPERS JJA and GORVEN and KGOELE AJJA

Heard: 7 May 2021

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Summary: Value-Added Tax Act 89 of 1991 – s 2(1)*(a)* – vendor conducting a currency exchange business through its branches – inputs acquired for use partly in making taxable supplies and partly in making exempt supplies – only entitled to deduct a portion of value added tax as input tax.

ORDER

On appeal from: Tax Court of South Africa, Gauteng (Maluleke AJ, sitting with assessors):

(a) The appeal is upheld with costs including those of two counsel.

(b) The order of the court below is set aside and substituted by:

‘The appeal is dismissed.’

JUDGMENT

Ponnan JA (Mbha and Schippers JJA and Gorven and Kgoele AJJA concurring)

[1] This appeal concerns the value-added tax (VAT) liability of the respondent, Tourvest Financial Services (Pty) Ltd. The respondent, a licensed dealer in foreign exchange, trades under the name American Express Foreign Exchange. The business of the respondent consists of 52 branches countrywide and a head office, with a centralised treasury division that procures stock of foreign currency and sets the exchange (buy and sell) rate at which the branches may transact with customers. A margin is built in to the quoted rates in favour of the respondent. The rate is set by taking the market exchange at any given time and adding a percentage mark-up thereto. The branches buy from - or sell to - customers at the exchange rate set by the treasury division, which is continually subject to change as the currency markets fluctuate.

[2] In essence, the respondent offers to sell foreign currency to the public at a rate in excess of the rate at which it acquires that currency and offers to buy foreign currency at a rate that is lower than the price at which it expects to sell that currency. In addition, the respondent charges a commission, based on a percentage of the transaction value. VAT is levied on the commission. A client purchasing foreign currency will therefore pay the respondent an amount made up of the quoted Rand value of the foreign currency, plus the commission and VAT. A client selling foreign

currency will receive the quoted Rand value of the currency, less the commission and VAT.

[3] The difference between the sale or purchase price and the value constitutes the respondent’s margin (or notional margin). To enable it to trade, the respondent purchases a stock of foreign currency at the supplier's rate. It hedges its foreign currency exposure by maintaining an overdraft, also denominated in foreign currency, to the same value. From time to time, the respondent closes out its net foreign exchange position. This means equalising the position between its foreign currency overdraft and the foreign currency held by it at the time.

[4] In the example provided by the respondent's witness, where at the end of a trading day it holds USD10 000 less in stock than the overdraft, the respondent would equalise its position by acquiring USD10 000 from the bank at the bank’s quoted rate. Conversely, if it holds excess foreign currency above its overdraft exposure, it would sell the excess at the bank’s rate. The margin or notional margin is the gross profit made out of trading the stock. The final margin is, however, ‘only truly known when the position is closed out’.

[5] Prior to September 2013, the respondent completed its VAT returns on the basis that not all the VAT paid by it on acquiring goods and services for its branches constituted deductible input tax. It, instead, applied an apportionment in terms of s 17(1) of the Value-Added Tax Act 89 of 1991 (the VAT Act). The apportionment was based on an acceptance that the relevant goods and services were acquired by the respondent partly for consumption or use in the course of making taxable supplies and partly for use in the course of making exempt supplies. However, after receiving tax advice, the respondent changed its stance in the September 2013 tax

period. It took the view that the goods and services obtained for the branches were in fact used by it wholly in the course of making taxable supplies and not at all in the course of making exempt supplies. Accordingly, so it concluded, no apportionment was required.

[6] On the view that it had overpaid VAT in each tax period over the prior five years, the respondent claimed an input tax deduction of R24 389 036.58 in the September 2013 tax period, which was paid by the appellant to the respondent on 19 November 2013. After a further audit on 5 April 2016, the appellant, the Commissioner for the South African Revenue Services, issued an additional assessment adding back the amount of R24 389 036.58, on the basis that the goods and services had been acquired by the respondent for use in the course of making both taxable and exempt supplies and accordingly an apportionment of input tax was necessary. The respondent's objection failed. Its subsequent appeal to the Tax Court of South Africa, Johannesburg, succeeded with costs. The additional assessment was set aside by Maluleke AJ, sitting with assessors.

[7] The Tax Court found that 'on the facts and evidence before us this [commission/fee] is the only payment that the customer makes to the [respondent] for the exchange of currency'. This was based on an earlier finding that 'the so-called margin (notional or otherwise) is not part of this agreement [between the respondent and the customer] as it is not known by either the appellant's treasury department/branch and the customer when the transaction is closed at the branch'. The margin, so the court found, 'happens much later when trades are closed between the bank and the [respondent's] treasury division at the end of the day'. The Tax Court went so far as to say that the issue of a 'notional margin ... [is] quite frankly irrelevant for purposes of deciding this case'.

[8] The issue for determination on appeal is thus whether the respondent, in conducting its enterprise of the exchange of currency through its branch network, makes both taxable and exempt supplies (as the appellant contends) or whether it only makes taxable supplies (as the respondent contends).

[9] Section 16(3)*(a)* of the VAT Act provides, subject, *inter alia*, to s 17, that the amount of tax payable in respect of a tax period shall be calculated by deducting from the amounts of output tax of the vendor, which are attributable to that period (plus certain tax refunds received), the amount of input tax in respect of supplies of goods and services made to the vendor during the tax period. 'Input tax' is defined, in relevant part, in s 1 of the VAT Act to mean:

'*(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;

(ii) . . .

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.'

[10] Accordingly, VAT incurred by a vendor: (a) wholly for the purpose of consumption, use or supply, in the course of making taxable supplies may be deducted in full as input tax; (b) wholly for the purpose of consumption, use or supply in the course of making exempt supplies, or for some other non-taxable purpose, may not be deducted as input tax at all; and (c) on goods or services acquired partly for the purpose of making taxable supplies and partly for the making of exempt supplies or some other non-taxable purpose (i.e. mixed supplies) must be

apportioned in accordance with s 17(1), and is only input tax (and hence deductible) to the extent that it pertains to a taxable supply.

[11] A 'taxable supply' is defined in s 1 as 'any supply of goods or services which is chargeable with tax under the provisions of section 7(1)*(a)*, including tax chargeable at the rate of zero per cent under section 11'. In terms of s 7(1)*(a)*, ' . . . there shall be levied and paid for the benefit of the National Revenue Fund a tax, to be known as the value-added tax, on the supply by any vendor of goods or services supplied by him on or after the commencement date in the course or furtherance of any enterprise carried by him'. To the extent here relevant, 'enterprise' is defined as follows in s 1:

'in the case of a vendor, any enterprise or activity which is carried on continuously or regularly by any person in the Republic . . . and in the course or furtherance of which goods or services are supplied to any other person for a consideration, whether or not for profit . . .
Provided that–
(v) any activity shall to the extent to which it involves the making of exempt supplies not be deemed to be the carrying on of an enterprise.'

[12] An 'exempt supply' is defined in s 1 of the VAT Act as 'a supply that is exempt from tax under section 12'. In terms of s 12*(a)*, the supply of any financial services shall be exempt from the tax imposed under s 7(1)*(a)*. Section 1 defines financial services to mean 'the activities which are deemed by section 2 to be financial services'. Section 2(1) of the VAT Act, which lies at the heart of the present appeal, provides, in relevant part, as follows:

'For the purposes of this Act, the following activities shall be deemed to be financial services:

(a) the exchange of currency (whether effected by the exchange of bank notes or coin, by crediting or debiting accounts, or otherwise);

(b) . . .

Provided that the activities contemplated in paragraphs *(a), (b), (c), (d), (f) and (o)* shall not be deemed to be financial services to the extent that the consideration payable in respect thereof is any fee, commission, merchant's discount or similar charge, excluding any discount cost.'

And, finally, 'consideration' is defined in s 1 (again in relevant part) as follows:

'in relation to the supply of goods or services to any person, includes any payment made or to be made . . . whether in money or otherwise, or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods or services, whether by that person or by any other person . . . .'

[13] With the introduction of VAT in 1991, the legislative policy was to treat the supply of identified financial services as exempt from VAT. This was because of perceived difficulties in establishing the value added by financial services on a transaction-by-transaction basis. The exchange of currency was, from the outset, identified in the VAT Act as an exempt financial service. That activity therefore did not attract VAT, even to the extent that a commission or fee was charged for performing the exchange. That changed in 1996 following the report of the Katz Commission, which set up a VAT Sub-Committee into the Taxation of Financial Services. In a report issued on 22 September 1995, it was recommended that fee-based financial services, which were exempt when VAT was introduced, should become subject to VAT.[1]

[14] The result was the introduction of the proviso to s 2(1) of the VAT Act. The Explanatory Memorandum on the Taxation Laws Amendment Bill, 1996, which introduced the proviso, stated:

'Since the introduction of the value added tax in 1991, the supply of financial services has been exempt from VAT mainly as a result of the difficulties in identifying and measuring the value added, particularly as regards interest. Although this principle is in line with the practice followed

[1] http://www.treasury.gov.za/publications/other/katz/3.pdf

by most countries, there is no reason why value added in respect of financial transactions should be treated differently from value added in other sectors of the economy. Financial services are furthermore consumed mainly by businesses and the more affluent section of the population. This principle was recognised by the Tax Commission and it was therefore recommended by them that all fee based financial services . . . should be brought into the VAT net.'

[15] It is so that the respondent carries on the activity of the exchange of currency as envisaged in s 2(1), which is, on the face of it, a defined financial service under s 2(1)*(a)* and is accordingly an exempt supply by virtue thereof. If no fee or commission were charged by the respondent as a consideration for that supply, the entire activity would be exempt, and no input tax could therefore be deducted. The proviso to s 2(1) states however that the activity of the exchange of currency shall not be deemed to be financial services 'to the extent that the consideration payable in respect thereof is any fee, commission ... or similar charge.' The effect of the proviso is thus limited to ensuring (in keeping with the intention, as expressed in the VAT Sub-Committee report, of bringing financial services into the VAT net) that any commission or fee charged in respect of the activity of the exchange of currency will attract VAT. To achieve this, it is necessary to carve out the activity from the definition of financial services for the limited purpose of making the provision of the goods or services taxable to that extent.

[16] The fact that, by virtue of the proviso, what would otherwise have been an exempt financial service is to an extent treated as a taxable supply (so that the commission carries VAT) does not mean that the activity loses its exempt nature entirely. It remains an exempt supply for all other purposes, while the taxable component carries VAT. It follows that the proviso creates a mixed supply out of an identified activity, rather than causing the activity to lose its exempt status in its

entirety. Accordingly, the effect of the proviso in the present context is merely to add a taxable element to what is, and at its core remains, an exempt financial service. It turns the activity into a partly exempt and a partly taxable supply. That being so, any tax paid on goods and services acquired by the respondent must be apportioned and only the part attributable to the taxable supply may be deducted as input tax. The respondent's attempt to claim the entire VAT charge as deductible input tax must therefore fail.

[17] It follows that the respondent's deduction in the September 2013 VAT return of the full unclaimed VAT expense over the previous 5 years was therefore impermissible. The inputs ought to have been apportioned. On this basis, the appeal must be upheld.

[18] In the event of the appeal succeeding, so the appellant had initially contended, a further issue fell to be decided, namely whether the interest imposed on the respondent in the additional assessment ought to be remitted. In that regard, the appellant had contended that the failure to make payment of the tax within the period for payment was not due to circumstances beyond the control of the respondent as envisaged in s 39(7)*(a)* of the VAT Act.[2] However, from the bar, counsel for the appellant eschewed s 39(7)(*a)*. Instead, reliance was sought to be placed on s 190(5) of the Tax Administration Act 28 of 2011 (the TAA).[3] But, the latter provision had

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[2] Section 39(7)*(a)* of the VAT Act provides:
'Where the Commissioner is satisfied that the failure on the part of the person concerned or any other person under the control or acting on behalf of that person to make payment of the tax within the period for payment . . .
(a) was due to circumstances beyond the control of the said person, he or she may remit, in whole or in part, the interest payable in terms of this section.'

[3] Section 190(5) of the Tax Administration Act provides:
'If SARS pays to a person by way of a refund any amount which is not properly payable to the person under a tax Act, the amount, including interest thereon under section 187(1), is regarded as an outstanding tax debt from the date on which it is paid to the person.'

not been invoked by the appellant when assessing the respondent to tax. In the circumstances, counsel rightly conceded that, for the present, s 190(5) of the TAA did not find application. It was nonetheless suggested that it was still open to the appellant to invoke s 190(5). Whether that be so, which remains for another day, need hardly detain us now.

[19] Costs remain: It goes without saying that before this Court, costs, including those of two counsel, should follow the result. As to the costs in the court below: Having upheld the appeal, the Tax Court ordered the appellant to pay the costs of the respondent. In the light of the contrary conclusion to which we arrive, the costs order of the Tax Court cannot stand. It was suggested on behalf of the appellant that it should be substituted with one directing the respondent to pay the appellant's costs. In my view, no warrant exists for such an order. It cannot, it seems to me, be said that the respondent's grounds of appeal were unreasonable, particularly as the respondent's change in stance was as a consequence of legal advice obtained. In all the circumstances there should be no order as to costs in the court below.

[20] In the result:

(a) The appeal is upheld with costs including those of two counsel.

(b) The order of the court below is set aside and substituted by:

'The appeal is dismissed.'

V M Ponnan
Judge of Appeal

APPEARANCES

For appellant:	M W Janisch SC (with R Tsele)
Instructed by:	State Attorney, Johannesburg State Attorney, Bloemfontein.
For respondent:	N G D Maritz SC (with T S Emslie SC)
Instructed by:	Shepstone & Wylie Attorneys, Johannesburg McIntyre van der Post Attorneys, Bloemfontein.