Input tax on raising fees

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Introduction

Can a VAT vendor claim input tax on related finance charges it incurs in acquiring finance for its business, for instances advisory fees, guarantee fees, introduction fees, raising fees, etc.?

The answer to this question depends on whether the services concerned meet the requirements of the definition of "input tax" in section 1 of the Value-Added Tax Act,, 1991 ("the **Act**"), but more specifically whether the "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 ... 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".

As to what constitutes "consumption, use or supply in the

course of making taxable supplies", two VAT cases dealt with it and are instructive, i.e.:

- the Cape Tax Court's *ITC 1744 (65 SATC 154) (2002)* and
- *the recent Supreme Court of Appeal case of C:SARS v De Beers Consolidated Mines Limited (74 SARS 330) (2012)* ("the **De Beers case**").

ITC 1744

In the case of ITC 1744 a vendor requiring capital in order to manufacture containers raised capital by employing the services of a company specializing in venture capital markets in return for remuneration for its services. The company levied output tax on its fee and the vendor claimed a corresponding input tax deduction. The issue was whether such deduction was allowable. It was held that a company cannot deduct the VAT paid on share issue costs, even if such costs are incurred to raise finance for a new business venture that would ultimately entail the making of taxable supplies. The court emphasised the principle that where goods or services are used for an exempt supply it is not legitimate for the taxpayer to look through that

supply to an ultimate purpose of carrying out taxable supplies.

De Beers Case

The De Beers case involved a complex transaction that was proposed to the board of De Beers, a public company, by takeover parties to which De Beers was related. This proposal amounted to a takeover of De Beers by these parties. A new private company that would become the holding company of De Beers' diamond operations and associated holdings would result at the end of the transaction.

De Beers engaged the services of NM Rothschild and Sons Ltd, a London-based company to advise its board on whether the proposed offer was fair and reasonable as required by the Securities Regulation Code pursuant to section 440C of the 1973 Companies Act. De Beers also appointed a number of South African advisors to advise it on various aspects in finalizing the transaction.

In assessing De Beers SARS determined that the VAT charged

and the local advisors did not qualify as input tax.

In deciding the matter the Supreme Court of Appeals ("**SCA**") held that what must be considered is whether the services consumed by De Beers were in the course of making taxable supplies in the course or furtherance of De Beers' enterprise.

The SCA found that the purpose of De Beers' acquisition of the advisory services was to acquire advice in relation to the takeover by parties related to De Beers, which the De Beers board was obliged to report to independent unit holders in terms of section 440C of the 1973 Companies Act.

This purpose meant that the advisory services acquired were unrelated to De Beers' core activities of mining and selling of diamonds and were not directed at making De Beers' diamond mining business better or more valuable (i.e. the look-through principle). They were acquired for the benefit of the departing shareholders. Therefore the services were found not to be consumed in the course of making taxable supplies in the course or furtherance of De Beers' enterprise.

Conclusion

It seems to us that ITC 1744's limited scope of the definition of "input tax" may have been overthrown by the SCA's De Beers judgment. In cases where the finance is directed at the vendor's core business of making taxable supplies, it may be that related finance charges would be closely connected to the "consumption, use or supply in the course of making taxable supplies".

SARS may however still prefer to follow ITC 1744 and vendors may have to take heed.