CASE LAW SUMMARY – May 2024

TUUP v Commissioner for the South African Revenue Service (VAT 22402) [2024] ZATC 1 (17 January 2024)

This is an appeal to the Tax Court by the taxpayer appealing a decision by the South African Revenue Service ("SARS") to disallow its application for a Binding Private Ruling in terms of section 41B of the Value-Added Tax Act No 89 of 1991 ("the VAT Act").

The facts and arguments

TUUP ("the taxpayer") is a public university that entered into a leasing agreement with a developer in 2009. In accordance with this agreement, the taxpayer leased land to the developer over a 20-year period. The developer was obliged to build student accommodation on the leased land, following which the taxpayer would lease the land and accommodation from the developer over a 15-year period so as to offer its students accommodation facilities.

Higher Education South Africa ("HESA") approached SARS in 2011 for a section 17 Class Ruling for all universities (the taxpayer was included in the universities covered under this ruling request and was also afforded the opportunity to provide input in the process of developing an agreed upon stance between HESA and SARS). SARS granted a ruling which stated the following:

- the rate applicable for input VAT claimable for research activities is to be determined by the nature of the research activity (with different rates applicable for different activities);
- a formula is to be applied to determine the input VAT claimable for all other non-research activities;
- in the event that the formula is applied, the input VAT claimable is limited to 12.5% of the VAT spent on goods and services.

The taxpayer, feeling that the Binding Class Ruling issued by SARS would not result in a fair outcome, approached SARS in 2019 for a Binding Private Ruling as it felt the Binding Class Ruling favoured research-intensive universities. The taxpayer was of the view that it should be entitled to an input VAT deduction on payments it made to the developer pertaining to the 15-year sub-lease; the input VAT being deducted from the output VAT arising from the taxpayer's taxable supply to the developer in terms of the 20-year lease.

SARS was however of the view that the entire lease agreement pertained to the provision of student residential accommodation (which is an exempt supply) and the taxpayer was therefore not entitled to an input VAT claim. The taxpayer further questioned whether the 12.5% cap imposed by SARS in its Binding Class Ruling was lawful, stating that SARS was not allowed to impose caps on apportionments. This line of argument was however only presented when the taxpayer delivered their heads of argument before the Tax Court.

SARS was however of the view that the cap was legitimate as it reflected how universities operate (the percentage had been decided upon after an 18-month investigation into various

universities operating and funding models and the ratio of expenses attributable to taxable supplies).

. In its application, the taxpayer's main request was that the 12.5% cap not apply to 20-year lease. SARS however contended that the separate treatment of input VAT claims as relates to research activities meant that all universities would be on equal footing, it therefore refused the taxpayer's request for a separate individual ruling. The taxpayer, feeling aggrieved by the fact that SARS was not willing to deviate from the content of the Binding Class Ruling approached the Tax Court.

Further reasons provided by SARS for disallowing the application included the fact that making this concession would distort the apportionment ratio, as well as the fact that the expenditure in question is a capital expenditure not under a rental agreement and therefore not catered for in the Binding Class Ruling it issued.

The judgment

As relates to the 12.5% cap the Court found that the taxpayer, in its application for an individual ruling, did not actually contest the legality of the cap. This based on the fact that its application actually relied on the cap as a mechanism for calculating the apportionment it sought. The Court was of the view that the taxpayer now questioning the legality of the cap was inconsistent and further denied SARS the opportunity to properly defend its stance. The Court further found that ruling on the legality of the cap would be prejudicial to HESA and the other universities impacted by the Binding Class Ruling as they were first and foremost not aware of the fact that its legality of the cap was being questioned.

Despite its above feelings the Court proceeded to rule on the legality of the cap. It found that there was nothing contained in section 17(1) of the VAT Act that precluded SARS from utilising the cap, all that SARS was required to ensure was that in the event that formulae, methodologies or ratios are utilised, that such properly reflect the vendor's use of taxable and exempt supplies. The Court further found that given SARS' research in reaching the cap, it could not be seen as arbitrary. Given the above, the Court found that the taxpayer's attack on the cap was not justified.

As relates to the taxpayer's ability to claim input VAT on the 20-year lease, the Court found that the two leases were in actual fact a single commercial agreement, as the existence of each lease depended solely on the other lease having occurred or occurring in future. Based on the above, the Court found that the taxpayer was not entitled to a VAT input as the entire agreement related to the provision of student accommodation which is an exempt supply. Further to the above, the lease in question did not increase the proportion of goods and service the taxpayer used to make taxable supplies.

The appeal was therefore dismissed, no order was made as relates to costs.

Editorial comments

Yet another reminder to taxpayers to pay close attention to the manner in which their contracts are drafted. As is common cause, the tax treatment of one's affairs can sometimes be decided by the content of one's contracts. The devil is indeed in the detail.