

SOUTH AFRICAN REVENUE SERVICE

BINDING PRIVATE RULING: BPR 069

DATE: 14 January 2010

ACT : VALUE-ADDED TAX ACT, NO. 89 OF 1991 (the VAT Act)
SECTION : SECTION 1, DEFINITION OF “INPUT TAX” AND SECTIONS 7(1)(a), 9(3), 16, 17 AND 20
SUBJECT : VAT IMPLICATIONS WITH REGARD TO THE SUPPLY OF SERVICES IN RESPECT OF WHICH MITIGATION COSTS AND MITIGATION SERVICES COSTS ARE RECEIVED, THE TIME OF SUPPLY OF SUCH SERVICES AND THE DEDUCTION OF VAT CHARGED ON SUCH SERVICES AS INPUT

1. Summary

This ruling deals with the VAT implications relevant to the supply of services by respective vendors in respect of which mitigation capital, operating and services costs are received. This ruling also deals with the time of supply of such services and the deduction of VAT charged on such services as input tax.

2. Relevant tax laws

This is a binding private ruling issued in accordance with section 41A of the VAT Act read with section 76Q of the Income Tax Act, No. 58 of 1962.

In this ruling legislative references to sections are to sections of the VAT Act applicable as at 19 May 2008 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the VAT Act.

This ruling has been requested under the provisions of –

- section 1, definition of “input tax”;
- section 7(1)(a);
- section 9(3)(b);
- section 16(2) and 16(3);
- section 17; and
- section 20

3. Parties to the proposed transaction

The Applicant: A company incorporated in the Republic of South Africa which is registered for VAT

Co-Applicant 1: A Provincial Government

Co-Applicant 2: A second company incorporated in the Republic of South Africa which is also registered for VAT

4. Description of the proposed transaction

Co-Applicant 1 has embarked upon the construction of a railway line, the initial alignment of which will pass through land owned by the Applicant. The Applicant intends to develop this land and the proposed development will encompass a major shopping centre, a residential township and mixed use areas.

The Applicant is of the view that the initial alignment of the railway line will effectively preclude the development of the proposed shopping centre which will have major negative implications for the development of the surrounding land.

The Applicant has been negotiating with Co-Applicants 1 and 2 with a view to mitigating the impact of the initial alignment of the railway line on the development through effecting a realignment of the railway line. The realignment of the railway line will require the approval of Co-Applicant 1 and any change in the initial alignment of the railway line will also result in a change in specifications in terms of the initial design and construction of the railway line.

Co-Applicant 1 has agreed to the realignment of the railway line on the basis that the Applicant agrees to carry the costs of such realignment and procures the mitigation services associated with the realignment from Co-Applicant 2. In this regard the parties propose to enter into an Agreement (the Realignment Agreement).

The payments which the Applicant will be required to make as a consequence of the realignment of the railway line are the following:

The Applicant will be liable to Co-Applicant 2 for the mitigation service costs associated with the realignment of the railway line which services will be carried out by Co-Applicant 2.

Notwithstanding the contractual relationships created by the Realignment Agreement, the amount payable by the Applicant in respect of the mitigation costs will be paid to Co-Applicant 1. Co-Applicant 1 will hold this amount on behalf of the Applicant until it is required to be disbursed as and when progress payments fall due in respect of the relevant realignment works.

Co-Applicant 2 is, in terms of an existing contract between it and a Concessionaire, entitled to progress payments calculated and timed in accordance with that contract. Neither Co-Applicant 1 nor the Concessionaire wish to depart from the current principles governing progress payments to Co-Applicant 2, therefore the Applicant will adopt the same principles in respect of the mitigation services costs.

Payments from the account held by Co-Applicant 1 for the mitigation services costs will constitute payment by the Applicant and will *pro tanto* discharge the Applicant's obligations to Co-Applicant 2 in respect of the mitigation services costs.

As Co-Applicant 1 will also incur mitigation capital costs (excluding the mitigation services costs) and mitigation operating costs as a consequence of the realignment of the railway line, the Applicant will also be liable to Co-Applicant 1 for these costs. The payment by the Applicant to the Co-Applicant 1 of such costs will discharge the Applicant's obligation to pay for such costs.

Co-Applicant 2 will issue tax invoices to the Applicant in respect of each progress payment to the extent payable by the Applicant, as and when the progress payments in respect of mitigation services costs fall due. Co-Applicant 1 will not levy VAT and will not issue tax invoices in respect of the mitigation capital costs and mitigation operating costs payable to it by the Applicant.

5. Conditions and assumptions

This ruling is made subject to the conditions and assumptions that:

- Where the mitigation services acquired by the Applicant in respect of the development of the land are wholly for purposes of use, consumption or supply in the course of making taxable supplies, the full amount of the VAT incurred on the realignment services may be deducted as input tax.
- Where the acquisition of the mitigation services by the Applicant in respect of the development of the land is partly for purposes of use, consumption or supply in the course of making taxable supplies, the VAT incurred on the mitigation services may only be deducted as input tax to the extent that it is incurred for purposes of use, consumption or supply in the course of making taxable supplies, that is, the VAT will have to be apportioned using an approved apportionment method as contemplated under section 17(1) of the VAT Act.

6. Ruling

The ruling made in connection with the proposed transaction is as follows:

Co-Applicant 1

- Co-Applicant 1 will not be making taxable supplies to the Applicant in respect of the mitigation capital costs or mitigation operating costs and will, therefore, not be entitled to issue a tax invoice to the Applicant in respect of the amounts payable to it by the Applicant in terms of the Realignment Agreement for the said costs.
- Co-Applicant 1 is not liable to account for output tax in respect of the amounts received from the Applicant in terms of the Realignment Agreement for the mitigation capital costs or mitigation operating costs.

Co-Applicant 2

- Co-Applicant 2 is obliged to levy VAT under section 7(1)(a) and account for the output tax under section 16(4) in respect of the mitigation services supplied to the Applicant in terms of the Realignment Agreement.
- Co-Applicant 2 is obliged to issue tax invoices to the Applicant under section 20 in respect of the mitigation services supplied to the Applicant in terms of the Realignment Agreement.
- Under section 9(3)(b) the time of supply of the mitigation services supplied to the Applicant by Co-Applicant 2 is the date on which the relevant progress payment that becomes due, is received by Co-Applicant 2 or the issue of an invoice by Co-Applicant 2, whichever is the earlier.

Applicant

- The VAT on any consideration payable by the Applicant to Co-Applicant 2 in respect of the mitigation services to be supplied in terms of the Realignment Agreement will be “input tax” as defined in section 1.
- The Applicant will, subject to sections 16(2), 16(3), 17 and 20, be entitled to deduct input tax in respect of the mitigation services acquired from Co-Applicant 2.
- The Applicant will not be entitled to “input tax” as defined in section 1 in respect of the acquisition of services from Co-Applicant 1 and for which the Applicant will pay for the mitigation capital costs (excluding the mitigation services costs) and mitigation operating costs to Co-Applicant 1 in terms of the Realignment Agreement.

7. Period for which this ruling is valid

This binding private ruling, issued in May 2008, will remain valid until the aggregate of all the amounts payable by the Applicant to Co-Applicants 1 and 2 in terms of the Realignment Agreement are disbursed.

Issued by:

**Legal and Policy Division: Advance Tax Rulings
SOUTH AFRICAN REVENUE SERVICE**