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VAT: Capitec Bank Limited v CSARS

Prof Des Kruger
Consultant: Webber Wentzel Attorneys

YOUR KEY TO THE TAX COMMUNITY

Facts

- Capitec lends money to unsecured borrowers, and charges interest (exempt) and fees (taxable).

- Capitec took out credit life insurance with an insurer to protect itself in the event that the borrower was unable to repay the loan due to death or retrenchment of the borrower.

- Capitec stipulated in its unsecured lending agreement in relation to loan cover that:

  “We do not charge any fees for the cover.”

- Capitec deducted the amount received by it from the insurer by way of set-off against the unsecured debt on the happening of the insurable event - R71 520 812 - under section 16(3)(*c*) of the VAT Act.

- Section 16(3)(*c*) of the VAT Act provides for a deduction against the vendor's output tax liability of an amount equal to the tax fraction (15/115) "*of any payments made during the tax period by the vendor* ***to indemnify another person in terms of a contract of insurance****: Provided that…this paragraph…shall only apply where* ***the supply of the contract of insurance is a table supply***"

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Essential requirements of section 16(3)(*c*) of the VAT Act are therefore that:

- Payment must be made to indemnify another person.
- Payment must be made "*in terms of*" a "*contract of insurance*."
- The supply of the contract of insurance must be a taxable supply.

- "*Contract of insurance*" defined by reference to definition of "*insurance*" – "***insurance or guarantee*** *against loss, damage, injury or risk of any kind whatever,* ***whether pursuant to any contract or law****, and includes…'contract of insurance*.'

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SARS

- Loan cover payments did not qualify for deduction under section 16(3)(*c*) as loan cover did not constitute a taxable supply, because:
    - Loan cover had been supplied for no consideration, therefore not an "*enterprise*" supply; and
    - The loan cover was in respect of an exempt supply.

Capitec

- Supply made for no consideration still a taxable supply – relied on s 10(23), but argued in any case that consideration was derived as linked to provision of interest and fees.

- Supply of loan cover linked to supply of both taxable (fees) and exempt (interest) supplies.

Tax Court

- Found in favour of Capitec.

- Agreed with Capitec that while no separate fee charged, cost was recovered at least in part from taxable fees, therefore unsecured lending business an "*enterprise*"
- .
- But found that there was no basis to treat the provision of credit and the activities which earned the fees as distinct and separate transactions.

- Seemingly agreed that the loan cover related wholly to Capitec "*enterprise*" activities and held that the provision of the loan cover accordingly constitutes a "taxable supply."

Supreme Court of Appeal (SCA)

- Upheld SARS' appeal.
- Held that no consideration was paid for the loan cover, therefore not taxable "*enterprise*" activity.
- Rejected the argument that s 10(23), that provides that where a supply is made for no consideration the value of th supply is nil, did not apply as provision did not have effect of changing the character of a non-taxable supply into a taxable supply.

Supreme Court of Appeal (SCA)

- Argued "*only one real ordinary insurance contract*", namely that between Capitec and the insurer.

- SCA was also concerned about symmetry. Noted that Capitec would have been entitled to input tax paid for VAT paid on premiums, while insurer would have had to account for output tax on insurance premiums received. When insurer paid out, it would have been entitled to a deduction, while Capitec would have been required to account for output tax on the deemed supply under section 8(8).

- Loan cover provided in the course of making exempt supplies.

Constitutional Court

- Expressed surprise that the case was conclude in the lower courts on the basis that the loan cover involved the supply by Capitec to a borrower of a "*contract of insurance*", but felt bound to accept that.

- Found that it could not be said that the loan cover was being supplied for "no consideration", as clearly related to the earning of interest and fees.

- Found that section 10(23) relevant as it envisages supplies (taxable or otherwise) may be made for no consideration.

Constitutional Court

- Held that while free-of-charge, the contract of insurance constituted a supply.

• As regards the question of whether the loan cover was supplied in the course of an exempt supply, the court found that related to both taxable (fees) and exempt (interest) supplies.

• Held that the deduction should be apportioned between taxable (fee) and non-taxable (fees). Importantly accepted that the legislated apportionment regime (section 17(1) of the VAT Act) could not be applied here as deduction not input tax as defined.

• Argued ample authority for apportionment and ren=mitted back to SARS for determination.

Issues

- "*Contract of insurance*"
    - Neither at common law (no premium) nor statutory law (Insurance Act).
    - Contract of insurance between Capitec and insurer.
    - Merely a form of security **for Capitec in the event of default.**
    - While loan cover constitutes a supply of services, nature of that service is the making available of an advantage or granting of a right**.**

Supply for no consideration

- Act envisages supplies being made for no consideration as part of carrying on a business (section 23).

- But does not change nature of supply, taxable or non-taxable depending on nature of supply, not whether consideration charged.

Apportionment

- Mandatory (section 17(1) of the VAT Act) where a vendor makes both taxable and non-taxable supplies and the vendor seeks to deduct "*input tax*" as defined – not the case here.

- Important principal that has been established is that the various deductions from output tax provided for in section 16(3) of the VAT Act could also fall to be apportioned where the goods or services supplied comprise taxable and non-taxable supplies.

THANK YOU

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