



THE SUPREME COURT OF APPEAL OF SOUTH AFRICA
JUDGMENT

Reportable

Case No: 94/2021

In the matter between:

**THE COMMISSIONER FOR THE
SOUTH AFRICAN REVENUE SERVICE**

APPELLANT

and

CAPITEC BANK LIMITED

RESPONDENT

Neutral citation: *Commissioner for the South African Revenue Service v Capitec Bank Limited* (94/2021) [2022] ZASCA 97 (21 June 2022)

Coram: SALDULKER, MOCUMIE, MAKGOKA and SCHIPPERS JJA and MUSI AJA

Heard: 10 March 2022

Delivered: 21 June 2022

Summary: Revenue – value-added tax – whether a tax fraction of loan cover payouts qualified for deduction in terms of s 16(3)(c) of the Value-Added Tax Act 89 of 1991 – whether loan cover qualified as a taxable supply – no

consideration charged for the loan cover – loan cover supplied in the course of business of providing credit – loan cover qualified as an exempt supply – penalty imposed under s 213 of the Tax Administration Act 28 of 2011 remitted.

ORDER

On appeal from: Tax Court, Cape Town (Sievers AJ, sitting as court of first instance):

1 The appeal is upheld with costs, including the costs of two counsel.

2 The order of the tax court is set aside and replaced with the following order:

‘2.1 The appeal is dismissed with costs, such costs to include the costs of two counsel.

2.2 The assessment for the November 2017 VAT return is confirmed.’

3 Any penalty imposed under s 213 of the Tax Administration Act 28 of 2011 read with s 39(1) of the Value-Added Tax Act 89 of 1991 by SARS is ordered to be remitted to Capitec Bank Limited.

JUDGMENT

Saldulker JA (Mocumie, Makgoka and Schippers JJA and Musi AJA concurring):

[1] The appellant, the Commissioner for the South African Revenue Service (SARS), appeals against the judgment and order of the Tax Court, Cape Town (the tax court), which upheld an appeal to it by the respondent, Capitec Bank Limited (Capitec), against the additional value-added tax (VAT) assessment raised by SARS for the November 2017 VAT return. In terms of the assessment, SARS disallowed an amount of R71 520 811.85 claimed by Capitec as a notional input tax deduction.

[2] The tax court held that Capitec was entitled to deduct this amount from its VAT liability by virtue of s 16(3)(c) of the Value-Added Tax Act 89 of 1991 (VAT Act), and it set aside the additional assessment for the November 2017 VAT return. The tax court directed SARS to refund to Capitec the amount of R71 520 811.85, together with interest at the prescribed rate from date of payment to date of refund. This appeal is with the leave of the tax court.

[3] Capitec is a registered bank which conducts business as a retail bank focussing on providing essential banking services, such as transactional banking (including savings and credit card facilities) and unsecured lending to its customers. The input tax deduction that Capitec claimed relates to its unsecured lending business, in terms of which Capitec advances credit in the form of personal loans to customers under term loan contracts. In terms of clause 13 of a standard loan contract entered into between Capitec and its customers, Capitec provided its customers with loan cover, the proceeds of which were applied to settle or reduce the outstanding loan amount due to Capitec in the event of the customer's death or retrenchment.

[4] The loan cover was underwritten by Guardrisk Life Limited (Guardrisk), commencing on 1 May 2015, to whom Capitec paid premiums. Before that, the loan cover was underwritten by Channel Life Insurance Limited (Channel). Under the insurance policies, Capitec is the insured and becomes entitled to the benefits, if the loan is not repaid on account of the death or retrenchment of the borrower. In essence, the loan cover was insurance taken out by Capitec, which covered it against the risk of outstanding amounts owing under the unsecured loans becoming irrecoverable upon the borrower's death or retrenchment. Thus, Capitec insured itself against the unpaid amount, resulting in the loan being paid in full and Capitec not suffering a loss of credit.

[5] During the VAT period from November 2014-2015, Capitec received payouts and made corresponding payments in respect of the loan cover in the amount of R582 383 753.66. Capitec claimed R71 520 811.85 as a deduction, which constituted the tax fraction of the total insurance payouts recovered by Capitec from its insurers and which Capitec used to settle the outstanding loans owed by its customers or their deceased estates in the event of their retrenchment or death.

[6] On 15 February 2018, SARS issued a VAT assessment in terms of which it disallowed the amount of R71 520 811.85 claimed by Capitec as a notional input tax deduction in its November 2017 VAT return, on the basis that it did not qualify for deduction in terms of s 16(3)(c) of the VAT Act. Additionally, SARS also levied a 10% late payment penalty for the resultant understatement of Capitec's VAT liability.

[7] According to SARS, the loan cover payments did not qualify for an input tax deduction in terms of s 16(3)(c) of the VAT Act, because the supply of the loan cover did not constitute a 'taxable supply'. SARS contended that since Capitec did not charge any consideration for the loan cover, and because the loan cover was supplied in the course of Capitec's business of providing credit to its customers, it was an 'exempt supply'. In contrast, Capitec contended that since the borrower had to pay interest and fees, consideration was provided for the loan cover, and alternatively that, even if the loan cover was for no consideration, it still levied a fee, termed a 'taxable supply', in terms of s 10(23) of the VAT Act. Furthermore, Capitec contended that although it does not charge a distinct fee for its loan cover, the loan cover was integral to its unsecured lending business, and thus to generating both interest income and fee

income, and that the cost of providing the loan cover was recovered through that income.

[8] The tax court held, *inter alia*, as follows:

‘[34] The clients contract for and receive no benefit over and above the loan itself, apart from the loan cover. Where no loan is advanced, no initiation fee is payable and no service fee is levied. Furthermore, as set out above in section 1 of NCA both “initiation fee” and “service fee” are defined (with Regulation 44(3)) by reference to the types of costs incurred by the vendor and not by reference to any particular service supplied to the customer. This is emphasized by the inclusion in the NCA of interest, initiation fee and the service fee, as sub-components under the heading “costs of credit” in section 101 thereof. The fee income, which is charged over and above interest in terms of a loan agreement, is part of the consideration payable for the provision of credit.

[35] The loan cover promotes and is made in the course and furtherance of an enterprise that includes the making of taxable supplies. These fees are a key component on the income side of Capitec’s business model. It would be uncommercial and inconsistent with Retief’s evidence in this regard to accept that the loan cover exclusively advances an exempt supply.

[36] The clients contracted to get a loan and not for other separate distinct services. The taxable fees recover costs to the bank and not services to the client. The NCA includes these with interest as being “costs of credit”. All three are the consideration paid for credit.

[37] As the supply of loan cover advances the entire business of advancing credit and this includes a taxable supply, the loan cover advances a taxable supply for consideration.

[38] The requirements of section 16(3)(c) are thus satisfied and Capitec qualifies for the deduction provided for therein.’

[9] The central question in this matter is whether the tax fraction of the loan cover payouts qualified for deduction in terms of s 16(3)(c) of the VAT Act. The determination of this issue is largely dependent on whether the loan cover was a taxable supply, ie whether it was supplied in the course or furtherance of an enterprise.

[10] The applicable provisions which govern the issues in this matter are as follows. In relevant part, ‘input tax’ in s 1 of the VAT Act is defined as:

- ‘(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;
 - ...

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.’

[11] Section 16(3) of the VAT Act governs the calculation of tax payable during each period. Section 16(3)(c) of the VAT Act provides for a deduction of an amount equal to the tax fraction of any payment made to indemnify another person in terms of any contract of insurance. The proviso in subparagraph (i) of s 16(3)(c) is that this paragraph shall only apply where the supply of that contract of insurance is a ‘taxable supply’. It provides, to the extent relevant, as follows:

- ‘(3) Subject to the provisions of subsection (2) of this section and the provisions of sections 15 and 17, the amount of tax payable in respect of a tax period shall be calculated by deducting from the sum of the amounts of output tax of the vendor which are attributable to that period, as determined under subsection (4), and the amounts (if any) received by the vendor during that period by way of refunds of tax charged under section 7(1)(b) and (c) and 7(3)(a), the following amounts, namely –

...

- (c) an amount equal to the tax fraction of any payment made during the tax period by the vendor to indemnify another person in terms of any contract of insurance: Provided that this paragraph –

- (i) shall only apply where the supply of that contract of insurance is a taxable supply or where the supply of that contract of insurance would have been a taxable supply if the time of performance of that supply had been on or after the commencement date.’

[12] Section 1 of the VAT Act defines the phrase ‘taxable supply’ as follows: “‘taxable supply’ means 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.’

[13] Section 7 of the VAT Act is the charging provision. Subject to exemptions and other exclusions, it provides for the charging of tax on supplies of goods and services. It provides, in relevant part, as follows:

‘(1) Subject to the exemptions, exceptions, deductions and adjustments provided for in this Act, there shall be levied and paid for the benefit of the National Revenue Fund a tax, to be known as the value-added tax –

(a) 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 on by him;

...

calculated at the rate of 15 per cent on the value of the supply concerned or the importation, as the case may be.’

[14] Section 1 of the VAT Act defines the term ‘enterprise’ as follows:

“‘enterprise’ means –

(a) in the case of any vendor, any enterprise or activity which is carried on continuously or regularly by any person in the Republic or partly 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, including any enterprise or activity carried on in the form of a commercial, financial, industrial, mining, farming, fishing, municipal or professional concern or any other concern of a continuing nature or in the form of an association or club;

...

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.’

[15] An exempt supply is defined in s 1 of the VAT Act as a supply exempt from tax under s 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 of the VAT Act provides, to the extent relevant, as follows: ‘(1) For the purposes of this Act, the following activities shall be deemed to be financial services:

...

(f) the provision by any person of credit under an agreement by which money or money’s worth is provided by that person to another person who agrees to pay in the future a sum or sums exceeding in the aggregate the amount of such money or money’s worth;

...

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.’

[16] ‘Consideration’ is defined, in relevant part, in s 1 of the VAT Act as follows: ‘in relation to the supply of goods or services to any person, [it] 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’.

[17] Lastly, s 1 of the VAT Act defines the term ‘insurance’ as follows:

“‘insurance’ means insurance or guarantee against loss, damage, injury or risk of any kind whatever, whether pursuant to any contract or law, and includes reinsurance; and ‘contract of insurance’ includes a policy of insurance, an insurance cover, and a renewal of a contract of insurance: Provided that nothing in this definition shall apply to any insurance specified in section 2.’

[18] Thus, the definition of ‘enterprise’ in s 1(1) is one of the most important definitions in the VAT Act as set out above. Its main purpose is to delineate as clearly as possible the type of persons, activities and supplies which are intended to form part of the tax base, as well as those that are meant to be excluded. In terms of paragraph (a) of this definition, there is a general requirement that enterprises participating in the VAT system must charge a consideration (or price) for the goods or services they supply.

[19] The general mechanism of the VAT Act has been conveniently set out by the Constitutional Court in the oft quoted judgment *Metcash Trading Limited v Commissioner for the South African Revenue Service and Another* [2000] ZACC 21; 2001 (1) SA 1109 (CC); 2001 (1) BCLR 1 (CC) as follows:

‘[13] . . . The basic idea of VAT is that it is calculated on the value of each successive step as goods move from hand to hand along the commercial production and distribution chain from their original source to their ultimate user. For present purposes it can be accepted that the tax is calculated at the prescribed rate of 14% on the price at which each successive act of handing on takes place. Furthermore, the tax is not only calculated on the value of each successive supply, but is to be paid at that time. As goods move along the distribution chain, everyone making up the sales chain is first a recipient, then a supplier. The Act calls these recipients/suppliers who are engaged in enterprises “vendors” and section 23 makes provision for them to be registered as such with the Commissioner. Section 7(2) of the Act then renders each vendor who supplies goods liable to pay the VAT on that particular supply.

[14] Being a tax on added value, VAT is not levied on the full price of a commodity at each transactional delivery step it takes along the distribution chain. It is not cumulative but merely a tax on the added value the commodity gains during each interval since the previous supply. To arrive at this outcome a supplying vendor, when calculating the VAT payable on the particular supply, simply deducts the VAT that was paid when the particular goods were supplied to it in the first place. As a commodity is on-sold by a succession of vendors, each payment of VAT by each successive supplier must then represent 14% of the selling price less the 14% of the price which was payable when that commodity was acquired. According

to the scheme of the Act the tax that is payable by a supplying vendor is called output tax and the tax that was payable on the supply to that vendor upon acquisition is called input tax.’

[20] Moreover, this Court in *Commissioner for South African Revenue Services v De Beers Consolidated Mines Ltd* [2012] ZASCA 103; 2012 (5) SA 344 (SCA); [2012] 3 All SA 367 (SCA), said:

‘[39] At this stage, it is necessary to set out the rationale behind and method of application of VAT. On this aspect we can do no better than to cite an English case which deals directly with this aspect in *Customs and Excise Commissioners v Redrow Group plc* [1999] 2 All ER 1 (HL) at 9g-h:

“These provisions entitle a taxpayer who makes both taxable and exempt supplies in the course of his business to obtain a credit for an appropriate proportion of the input tax on his overheads. These are the costs of goods and services which are properly incurred in the course of his business but which cannot be linked with any goods or services supplied by the taxpayer to his customers. Audit and legal fees and the cost of the office carpet are obvious examples.” These considerations apply equally to the VAT regime in this country and in other comparable jurisdictions.’

And further:

‘[51] The primary question requires that there be clarity as to the nature of the “enterprise” because the purpose of acquiring the services and whether they were consumed or utilized in making “taxable supplies” can only be determined in relation to a particular “enterprise”. What the “enterprise” consists of is a factual question. There must be a particular activity which complies with all the requirements in the definition. . . The purpose of the words following “including” is to make certain that the specific categories of activity referred to are included in the definition of “enterprise”.’

[21] In determining whether a vendor is entitled to deduct as input tax the VAT paid on the respective goods/services supplied to it, this Court in *Consol Glass (Pty) Ltd v The Commissioner for the South African Revenue Service* [2020] ZASCA 175 (SCA), said:

‘[14] Whether Consol was entitled to deduct as input tax the VAT paid on the services supplied to it by local service providers depended upon whether these services were acquired

by Consol for the purpose of consumption, use or supply in the course of making taxable supplies. That enquiry raised two issues. First, for what purpose did Consol acquire the services? Second, did Consol do so in the course of making taxable supplies. The relationship between the purpose for which the services were acquired and the use to which these services were put lies at the heart of the matter.’

[22] VAT is a tax that is ultimately meant to be charged upon the consumer in the supply chain. Thus, the obligation to recover or collect VAT is placed on the vendors who are traders, and whose business it is to add value on goods and services; in this case, Capitec. The outgoing supply that is made by the vendor, on which it must collect VAT, must be matched with the incoming supply which is supplied by other vendors to Capitec, and in respect of which input tax is levied. In a very able argument, Mr Nxumalo, led by Ms Cane SC on behalf of SARS, referred to this as the ‘matching principle’. Thus, in terms of the VAT Act a vendor who supplies taxable supplies is required to collect the VAT on its taxable supplies, and the total of the output tax is collected and is paid out by the vendor on behalf of the national revenue service. Correspondingly, the input tax that is charged to and paid by the vendor may be deducted and recovered from the national revenue service. But, this is conditional upon the input tax in respect of the incoming supplies being used by the vendor or acquired for the purpose of making taxable supplies.

[23] Mr Janisch SC for Capitec contends that because Capitec carries on business as a single business offering credit, and in the course of such business it earns interest income which is exempt, and earns a fee income which is taxable, and because the loan cover was supplied as part and parcel of the credit offering business, there was thus a direct link between the supply of the loan cover and the credit supply. That is correct. However, what cannot be ignored is that Capitec is in the business of providing credit. It is not in the business of

providing insurance. The provision of credit is an ‘exempt supply’, because it is deemed a financial activity in terms of s 2(1)(f) of the VAT Act. A minor component of its business is in the form of fees, which is a taxable supply. The question, therefore, is whether the entire business activity of Capitec, which is largely exempt, should be treated as a taxable supply.

[24] As explained in *Commissioner for the South African Revenue Services v Tourvest Financial Services (Pty) Ltd* [2021] ZASCA 61; 2021 (5) SA 86 (SCA) para 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.’

And at para 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.'

[25] Thus, it follows from *Tourvest* that where a vendor carries on the business of providing financial services, that remains its main business. The fact that there may be some taxable fees that are earned in the course of its business which can be carved out does not convert what is in essence a taxable supply (and what is in the main an exempt supply) into a taxable supply. Thus, the fact that fees charged by Capitec for its services carry VAT does not mean that the activity of supplying credit loses its exempt nature. Instead, the minor part of its business which is the earning of taxable fees may be carved out as such and claimed accordingly.

[26] Nevertheless, it remains to be determined whether these fees were, in fact, charged by Capitec in the supply of the loan cover to its customers. This is because although the loan cover is linked to Capitec's main business of supplying credit, for which the fees charged may be taxable, SARS contends that the loan cover was, in fact, supplied for no consideration to the customers, and the fees applied solely to the provision of credit services by Capitec.

[27] From the facts, the following emerges. The loan cover was supplied by Capitec to its customers for no consideration for the following reasons. Capitec does not charge its clients for credit insurance. This is clear from the following:

- (i) In terms of the loan contract entered into between Capitec and its customers, the loan cover was supplied free of charge. The Pre-Agreement Statement and Quotation for Credit Agreements expressly stipulates that 'no credit life insurance or optional insurance is charged'.
- (ii) Clause 4 of the term loan contract stipulates, to the extent that it is relevant, that:

‘4 INTEREST AND FEES

4.1 . . . Interest will only be charged on amounts actually lent and advanced to you. The interest rate is a fixed one.

4.2. . . . The monthly service fee will be levied on the same date as instalments as described in Section A of this agreement.

In terms of Section A of the loan contract, the annual interest rate is 31.750% and the monthly service fee is R57.00, and that ‘no credit life insurance or optional insurance is charged.’

(iii) Clause 13 of the term loan contract provides for the loan cover and it stipulates, to the extent that it is relevant, that:

‘13 LOAN COVER

13.4 We do not charge any fees for the cover.’

(iv) In terms of Capitec’s 2016 Integrated Annual Report, the chief financial officer (CFO) states that, ‘[w]e continue to insure our book against events relating to retrenchment (non-government) and the death of all our clients. The full value of any outstanding loan is insured. . . This insurance protects Capitec from bad debts, but also benefits our clients. When retrenched, our clients have a safety buffer and in the case of death, Capitec does not claim against their deceased estates. *We do not currently charge our clients credit life or retrenchment insurance as this is built into the interest rate we charge our clients . . .*’. (Own emphasis.) This emphatic assurance by the CFO that Capitec does not charge clients for insurance cover again evidences that the loan cover was supplied for no consideration.

(v) The supply of credit is regulated by the National Credit Act 34 of 2005 (the NCA). Section 101 of the NCA¹ provides for a description of the cost of credit.

¹ Section 101 of the National Credit Act 34 of 2005 reads:

‘(1) A credit agreement must not require payment by the consumer of any money or other consideration, except—

(a) the principal debt, being the amount deferred in terms of the agreement, plus the value of any item contemplated in section 102;

(b) an initiation fee, which—

(i) may not exceed the prescribed amount relative to the principal debt; and

(ii) must not be applied unless the application results in the establishment of a credit agreement with that consumer;

(c) a service fee, which—

It states that, '[a] credit agreement must not require payment by the consumer of any money or other consideration, except' as provided for in terms of this section. Thus, Capitec, as the credit provider, may only charge the consumer such fees as provided for in terms of the NCA. Accordingly, the initiation fee and the service fee in the supply of credit by Capitec is regulated. Thus, these fees cannot include or comprise an amount charged for insurance cover, which is separately provided for in terms of s 101(1)(e) read with s 106 of the NCA.

[28] It is common cause that Capitec did not provide credit insurance in terms of s 106 of the NCA. Instead, Capitec opted to provide insurance cover without charge to the consumer. And so, it did not have to comply with the provisions and regulations in terms of s 106 of the NCA. Thus, the initiation fees and the monthly service fees, as regulated under the NCA, could not, in terms of legislation (including regulations 43 and 44), constitute charges for the loan cover. Had there been a charge for the loan cover, Capitec would have had to comply with s 106 of the NCA. It avoided that obligation by electing not to charge for the loan cover, and in this regard repeatedly reassured the customer that there is no fee charged for the loan cover.

[29] In view of all the foregoing, the clear and unambiguous terms of the loan contract indicate that the client was to receive loan cover from Capitec free of

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- (i) in the case of a credit facility, may be payable monthly, annually, on a per transaction basis or on a combination of periodic and transaction basis; or
 - (ii) in any other case, may be payable monthly or annually; and
 - (iii) must not exceed the prescribed amount relative to the principal debt;

(d) interest, which—

- (i) must be expressed in percentage terms as an annual rate calculated in the prescribed manner; and
- (ii) must not exceed the applicable maximum prescribed rate determined in terms of section 105;

(e) cost of any credit insurance provided in accordance with section 106;

(f) default administration charges, which—

- (i) may not exceed the prescribed maximum for the category of credit agreement concerned; and
- (ii) may be imposed only if the consumer has defaulted on a payment obligation under the credit agreement, and only to the extent permitted by Part C of Chapter 6; and

(g) collection costs, which may not exceed the prescribed maximum for the category of credit agreement concerned and may be imposed only to the extent permitted by Part C of Chapter 6.'

charge, ie no consideration was received by Capitec in respect of its supply of the loan cover. Therefore, in the absence of a consideration, the supply of the loan cover did not qualify as an ‘enterprise’ as envisaged in s 1 of the VAT Act. It was therefore not chargeable with tax in terms of s 7(1)(a) of the VAT Act – which charges tax on supplies in the course or furtherance of an enterprise.

[30] In terms of the definition of an enterprise in the VAT Act, there is a general requirement that enterprises participating in the VAT system must charge a consideration (or price) for the goods or services they supply. Thus, the implication of not meeting this requirement is that supplies made for no consideration are not made in the course or furtherance of an enterprise, and hence, will not be a taxable supply. It is important to correctly characterise a particular supply as being taxable or not, because the vendor will generally have a right to deduct the VAT incurred on any goods or services acquired for the purposes of making taxable supplies, but will not be able to do so if the supplies are exempt, out-of-scope, or in connection with any other non-taxable activities conducted by the vendor.

[31] It is important to understand the true nature of the loan cover that Capitec provided to its clients, on the one hand, and the credit insurance policy between Capitec and its insurers, Channel and Guardrisk, on the other hand. In reality, what the insurance contracts show is that there is only one real ordinary insurance contract, which is between Capitec and its insurers. And the purpose of the contract is to cover the credit risk that Capitec is exposed to in terms of its unsecured lending business. In this scenario the insurance contract has only one consequence, but it benefits two parties. Simply put, the benefit is that in the event that Capitec’s client dies or is retrenched, the risk becomes incurred for Capitec and then Guardrisk needs to pay out the policy. Notably, that indemnity payout, in the hands of Guardrisk, qualifies for deduction in terms of

s 16(3)(c) of the VAT Act, because Guardrisk is the insurer undertaking the insurance business. While the payout of the insurance contracts benefits both Capitec and its customers – since the payouts from the insurers is credited to the loan account of the customer – who no longer owes Capitec in this regard – the benefit to the customer is incidental.

[32] Furthermore, the Loan Book Cover Scheme Insurance Policy between Capitec and Guardrisk provides that ‘[a]ny Benefit payable in respect of a Life Insured in terms of this Policy shall be paid by the Insurer to Capitec Bank (the Policy Owner) who will apply the said Benefit towards settlement of the Life Insured’s loan that is due and payable to Capitec Bank’. This represents an accurate recordal of the nature of the relationship between Capitec and the insurer. There is only one insurance contract, but with the same benefit arising out of the single insurance contract to both Capitec as the insured and its customer in terms of the loan cover, separately. Guardrisk paid output tax on the premiums it collected from Capitec. It was allowed a notional tax deduction in terms of s 16(3)(c) of the VAT Act in respect of its payout settlement that it paid to Capitec. In this way the matching principle is satisfied and the books of Guardrisk are balanced.

[33] With regard to Capitec, it was allowed an input tax deduction in respect of the premiums it paid to Guardrisk and when Guardrisk paid out the indemnity payments it was deemed in terms of s 8(8) of the VAT Act² to have supplied to

² Section 8(8) of the VAT Act provides:

‘(8) For the purposes of this Act, except section 16(3), where a vendor receives any indemnity payment under a contract of insurance or is indemnified under a contract of insurance by the payment of an amount of money to another person, that payment or indemnification, as the case may be, shall, to the extent that it relates to a loss incurred in the course of carrying on an enterprise, be deemed to be consideration received for a supply of services performed on the day of receipt of that payment or on the date of payment to such other person, as the case may be, by that vendor in the course or furtherance of his enterprise: Provided that this subsection shall not apply in respect of any indemnity payment received or indemnification under a contract of insurance where the supply of services contemplated by that contract is not a supply subject to tax under section 7(1)(a): Provided further that this subsection shall not apply in respect of any indemnity payment received by a vendor under a contract of insurance to the extent that such payment relates to the total reinstatement of goods, stolen or

Capitec, Capitec was required to pay output tax on the indemnity payment it received from Guardrisk. Thus, the equilibrium was achieved in Capitec's books in that both the input tax deduction and the output tax were accounted for. However, Capitec wants to treat that same deemed supply as a new notional input tax deduction. If it does so, this will leave the books of Capitec skewed, as this would result in there being deductions of input tax without any corresponding output tax, because the output tax that is deemed to have been received in terms of s 8(8) is immediately reversed by this notional deduction. In any event the obtaining of the Guardrisk insurance as between Guardrisk and Capitec is not a 'taxable supply' vis-à-vis Capitec's customer. The only supply between Capitec and its customers is the supply of credit, which is exempt.

[34] Furthermore, in terms of the credit insurance policies, Capitec was insured against the 'outstanding loan amount', which was the loss of the capital amount of the credit provided and the capitalised amount of interest and fees. All this constituted the provision of credit to its customers. Thus, on Capitec's own version the purpose of the loan cover was to protect Capitec against the risk that its customers would default on their loan, on account of retrenchment or death. The insurance policy settled that amount, thereby extinguishing the credit risk to Capitec. This was the purpose and effect of the loan cover. Thus, because the provision of credit is an exempt financial service, the loan cover was supplied in the course of making an exempt supply and was therefore not deductible by Capitec in its VAT return. There is thus nothing to the distinction sought to be made between the loan cover between Capitec and its clients and the insurance contracts between Capitec and Guardrisk. It is the same contract and benefits both Capitec and its customers.

damaged beyond economic repair, in respect of the acquisition of which by the vendor a deduction of input tax under section 16(3) was denied in terms of section 17(2) or would have been denied if these sections had been applicable prior to the commencement date.'

[35] It is important to note that the fees charged by Capitec to its customers, ie the initiation fee and the monthly service fees, are payable on accrual and are taxable supplies. If they are not paid immediately, they become capitalised and added to the balance of the outstanding loan, which renders them exempt. When the bank raises the monthly service fees it immediately debits the customer's account. But, if for any reason the account does not have funds, then that account will fall into arrears and the amount of the fees will be added to the balance outstanding. Once it is in the account, it then forms part of what is insured under the loan cover; it forms part of the balance owing by the client, and because it has been capitalised it is additional credit in respect of the overdue fees and the latter effectively becomes an additional loan. In this way, the only fees that will form part of the balance of the outstanding loan amount are overdue fees. Those overdue fees, the moment they become overdue, become additional credit advanced to the customer. Thus, the loan cover relates exclusively to the supply of credit; whether that credit pertains to the capitalised amount or the accrued and capitalised interest fees, it is all credit.

[36] In my view, SARS is correct when it contends that the fact that the credit insurance policies' benefit may include capitalised fees in the circumstances where the client has fallen into default does not mean that the loan cover insured the earning of fees. It did not. It insured the recovery of the credit advanced (which at times included arrear capitalised fees). The earning of fees was not subject to credit risk, but the recovery or collection of arrear amounts owed by the customers, which included capitalised fees, was subject to credit risk. The supply of services for which fees were paid were completed by the time the initiation fee was charged and the debit for the monthly instalment (inclusive of that fee) was raised. If the debit order was returned unpaid, Capitec automatically extended additional credit to the borrower in the amount of the

unpaid instalment, which was a separate supply (of credit) and not a supply of further services.

[37] Thus, the loan cover was supplied in the course of making exempt supplies, because the credit insurance policies ensured the recovery of the credit advanced to customers. The payouts from the credit insurance policies settled the credit balance owing, and extinguished the credit risk arising in the event of retrenchment or death of the customer. This was the purpose and effect of the loan cover.

[38] Mr Retief, who testified for Capitec, was driven to concede that the customers of Capitec did not pay any consideration for the loan cover. That much was clear from the term loan contracts. Capitec made an exempt supply of credit available to its clients, which was not deductible, and all other activities involved in doing so were incidental to the supply of credit, because the supply of the loan cover was not a taxable supply in terms of s 16(3)(c) of the VAT Act. Therefore, the supply of the loan cover was not a taxable supply as required by the first proviso to s 16(3)(c)(i) of the VAT Act. On this basis alone, the tax fraction of the loan cover payouts did not qualify for deduction. Consequently, the main question in this appeal must be answered in favour of SARS.

[39] Mr Janisch contended that because s 16(3)(c) of the VAT Act deals with notional input tax deduction and not with actual input tax deduction, the apportionment provision of s 16 does not apply. I disagree. Section 16 states clearly in its opening paragraph that s 16 is subject to s 17, and s 17 is the apportionment provision of the VAT Act for the apportioning of notional input tax deduction. Actual input tax relates to the actual amount of tax that was charged and paid by the vendor, and which is subject to s 16(3). Section 16(3) of the VAT Act is expressly subject to s 17. Section 17(1) governs the deduction

of VAT incurred in acquiring supplies intended partly for use in making taxable supplies and partly for use in non-taxable supplies (mixed supplies). In *C: SARS v De Beers Consolidated Mines*, this Court stated that:

‘[40] . . . Where a vendor acquires goods or services partly for use in making a taxable supply and partly for use in a non-taxable supply, section 17(1) dictates an apportionment based on the ratio which the former intended use bears to both intended uses.’

[40] It is clear from *Tourvest* and s 17 of the VAT Act that where the activity includes a small component of taxable supplies, a deduction for input tax will only be allowed to the extent of the taxable portion. In some instances, apportionment instead of a full deduction may be feasible. Thus, the logical conclusion must be that if it is a mixed supply, the vendor cannot claim the full amount of the notional input tax as Capitec has done in this case.

[41] Furthermore, the legislature could not have intended that vendors who have incurred actual input tax would claim limited deductions in respect of what they have actually incurred and paid, and those who have not actually incurred but have notionally incurred, would be allowed a full deduction. The submission that there is no mechanism in the VAT Act for apportionment for notional input tax by Capitec is thus misconceived.

[42] In any event, Capitec did not apportion the deduction in its return, nor did it plead apportionment as a ground of objection to SARS’s assessment or ground of appeal. In view of Capitec’s failure to plead apportionment as a ground of objection and of appeal, there would be no basis to allow an apportionment and SARS was correct to disallow Capitec’s deduction of the whole amount, on this basis alone. The taxpayer bears the onus in the tax court, and must prove apportionment. Capitec did not raise the issue of a mixed supply in the tax court.

Thus, this Court cannot decide this issue on appeal. Capitec adopted an all or nothing approach. Capitec bore the onus and did not discharge it.

[43] Additionally, Capitec attempts to rely on paragraph 5.2.2 of SARS Interpretation Note 70 (IN70) to contend that the practice generally prevailing was that ‘a supply made for no consideration in the context of business is generally regarded as a taxable supply’. Capitec contends that paragraph 5.2.2 of IN70 constitutes a practice generally prevailing as defined in s 5(1) of the Tax Administration Act 28 of 2011 (TAA). Section 5 of the TAA defines ‘practice generally prevailing’ as ‘a practice set out in an official publication regarding the interpretation or application of a tax Act’. However, paragraph 5.2.2 of IN70 also states that ‘when exempt or other non-taxable supplies are made for no consideration, no output tax is declared and no input tax is deducted by the vendor’. Further, that ‘the general rule will also not apply when the supplies concerned are characterised as exempt or out-of-scope for VAT purposes, because to that extent, the supplies are not made in the course or furtherance of the ‘enterprise’ (Refer, for example, proviso (v) to the definition of “enterprise” in section 1(1) which specifically excludes exempt supplies.)’.

[44] It is thus clear that IN 70 does not seek to change the principle in the VAT Act that no deduction is permissible in respect of supplies, whether for consideration or not, in the course of making exempt supplies. On this basis, reliance on the pleaded practice generally prevailing by Capitec is misplaced.

[45] Capitec has also based its argument on s 10(23) of the VAT Act, which in my view is ill conceived. The section provides in relevant part that: ‘Save as otherwise provided in this section, where any supply is made for no consideration the value of that supply shall be deemed to be nil.’

The purpose of s 10(23) of the VAT Act is merely to provide a valuation rule which determines that the value of a supply will be nil in certain instances. The rule cannot be used to characterise a supply as being taxable or non-taxable. In other words, the valuation rule does not have the effect of changing the character of a non-taxable supply for no consideration into a taxable supply for no consideration just because the person happens to be a vendor in respect of other (taxable) supplies made.

[46] Lastly, the matter of the penalty levied on Capitec must be dealt with. In terms of s 213 of the TAA read with s 39(1) of the VAT Act, SARS levied a 10% penalty on Capitec for the underpayment of VAT arising from the deduction of notional input tax in respect of the loan cover payouts.

[47] Section 217(3) of the TAA provides for the remission of the penalty levied if certain requirements are met. It provides as follows:

- ‘(3) If a “penalty” has been imposed under section 213, SARS may remit the “penalty” or a portion thereof, if SARS is satisfied that –
- (a) the “penalty” has been imposed in respect of a “first incidence” of non-compliance, or involved an amount of less than R2 000;
 - (b) reasonable grounds for the non-compliance exist; and
 - (c) the non-compliance in issue has been remedied.’

[48] This was the first time a penalty had been imposed by SARS on Capitec in the three years preceding the relevant VAT return. In my view there were reasonable grounds for Capitec claiming the deduction: Capitec had obtained a favourable opinion from a senior counsel; and the only way Capitec could reasonably test the issue was to claim the deduction in its tax return. In such circumstances the penalty should be remitted, as it cannot be said that the contesting of the amount was unreasonable.

[49] For all of the foregoing reasons, the appeal succeeds.

[50] In the result, the following order is made:

1 The appeal is upheld with costs, including the costs of two counsel.

2 The order of the tax court is set aside and replaced with the following order:

‘2.1 The appeal is dismissed with costs, such costs to include the costs of two counsel.

2.2 The assessment for the November 2017 VAT return is confirmed.’

3 Any penalty imposed under s 213 of the Tax Administration Act 28 of 2011 read with s 39(1) of the Value-Added Tax Act 89 of 1991 by SARS is ordered to be remitted to Capitec Bank Limited.

H K SALDULKER
JUDGE OF APPEAL

APPEARANCES

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