Western Cape Government

FOR YOU

THE VAT EXCHANGE: INSIGHTS FROM THE WESTERN CAPE

ASB VAT EDUCATION SESSION

01 OCT 2025

The VAT Landscape

- **VAT is a transactional tax that binds the state (S86 of VAT Act)**
- **The VAT 419 – Guide for Municipalities was first issued on 31 Oct 2008 (Latest Version 2017)**
- AGSA has set a deadline (2024/25) to resolve VAT complexities
- ***Complexity stems*** *from provincial functions performed by municipalities (housing, roads, clinics, libraries) and misalignment between contract law and commercial substance*
- ***The Golden Rule: Substance over legal form is KEY***
  - *NT SCOA classification circular 21 (May 2018) – Transfers and Subsidies VS Goods and Services*
  - *SCA AGSA vs MeC Economic Opportunities judgement (2021)*
  - *OAG-TSS guidance on principal/agent arrangements (2022)*

The VAT Landscape *(continued)*

- **VAT ramifications** including potential associated ***UIFWE*** effects and possible *financial misconduct and financial offences*
- ***VAT 404 – Guide for Vendors*** and the ***TAA No. 28 of 2011*** guides all on the ***administration***
- ***S240 TAA defines a tax practitioner***, ***every natural person*** *who* ***provides advice*** *to another person with respect to the application of a tax Act; or completes or assists in completing a document to be submitted to SARS by another person in terms of a tax Act.*
- *PT* ***does not*** *have this expertise within our establishment*
- *PAG issued a vetted communication on 27 Jul 2023*
- *SARS/NT VAT Training – Sept 2023*

Library Function Factual Matrix

- Services rendered by the WC municipalities in terms of the agreement with the DCAS means the library service as contemplated in **Schedule 5A to the Constitution**
- The executive functions relating to library services was assigned to the MEC for Cultural Affairs and Sport ***prior to 27 Jun 2025***
- Western Cape municipalities are required to perform free provincial library services in their area for the funding received from the DCAS
- The municipalities have an agreement with the DCAS to render free provincial library services to the general public living in the municipality's area
- Understanding of the output tax treatment on the payments is **KEY**
- DCAS drove the assignment of the library function to municipalities on 27 Jun 2025 per a proclamation in Provincial Gazette 9095

Accounting on the library matters in our Province

Audited AFS Disclosure 2023/24

Summary of how WC Municipalities have disclosed their potential VAT liability on library payments in their audited Annual Financial Statements for 2023/24

Liability/Payable	Provision	Contingent Liability	Unknown
8% of portfolio (2 munis)	**64% of portfolio (16 munis)**	**24% of portfolio (6 munis)**	**4 % of portfolio (1 muni)**
Indicates a present obligation arising from past events, the settlement of which is expected to result in an outflow from the entity.	Indicates a liability of uncertain timing or amount.	Discloses the uncertainty of the event rather than recognising a liability.	Silent in their AFS on this matter.

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Audited AFS Disclosure 2023/24 *(Case 1)*

Liability: Note 48 - reclassification of the VAT payable to SARS as Trade and other payables for legacy amount owing.

Revenue: the classification of the library management fees as sales of goods and services rendered – Revenue from Exchange per GRAP 9

25. Sales of goods and rendering of services

Advertisements	34,924	3,739
Building Plan Approval	8,231,330	9,860,093
Camping Fees	1,022,572	877,320
Cemetery and Burial	3,015,825	3,143,541
Cleaning and Removal	193,277	336,996
Demolition Application Fees	5,387	11,406
Entrance Fees	623,569	781,260
Legal Fees	1,137,622	1,451,554
Library Fees	24,990	37,476
Management Fees (Library)	18,606,957	17,351,304
Occupation Certificates	707,287	599,141
Photocopies and Faxes	262,755	244,833
Sale of Goods	41,466	62,951
Total	**33,907,961**	**34,761,614**

Audited Annual Financial Statements for the year ended 30 June 2024

Notes to the Audited Annual Financial Statements

Figures in Rand	2024	2023

48. GRAP 3 adjustments (continued)

Library Grant output VAT correction

During the year the output VAT payable to SARS was reviewed and adjustments were made accordingly.

Opening balance as at 1 July 2022 effects	
Accumulated surplus	(2,835,130)
Trade and other payables from exchange transactions (VAT accrual on receivables)	2,835,130
	-

Audited Annual Financial Statements for the year ended 30 June 2024

Notes to the Audited Annual Financial Statements

Figures in Rand	2024	2023

58. Contingent liabilities (continued)

Arbitration cases
The municipality has 4 (2023: 4) ongoing arbitration cases, which varies in circumstances. The maximum exposure for the municipality amounts to R1,466,378 (2023: R1,058,962).

VAT - Library Grant
The municipality has submitted a request for a non-binding private opinion to the South African Revenue Service (SARS) concerning the output tax treatment of the library funding received from the Western Cape Department of Cultural Affairs (DCAS). The objective of the opinion request is for the SARS to confirm if the municipality must declare output tax at 15% (14% before 1 April 2018) or zero % on the funding received from the DCAS. The municipality has received a non-binding VAT ruling regarding the matter and provision was made for the output VAT payable.

According to Section 217 (3) of the Tax Administration Act (TAA), the municipality may be levied with penalties and interest by SARS for the late declaration and payment of output VAT. The penalty rate and interest charged will be determined by SARS as various considerations need to be taken into account to calculate this amount. The municipality's best estimate for these penalties and interest payable amounts to R2,431,888 (2023: R3,129,520).

Audited AFS Disclosure 2023/24 *(Case 2)*

Per note 19 - **A provision per GRAP 19** as the municipality is still awaiting a ruling from SARS on the matter

Per note 24.08 - **Revenue from Exchange per GRAP 9**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2024

Figures in Rand		2024	2023
19	CURRENT PROVISIONS		
	Awaiting SARS Ruling - Output VAT Payable on Library Grants	6 197 478	5 096 478
	Total	6 197 478	5 096 478
	As previously reported		-
	Correction of error restatement - note 48.2		5 096 478
	Restated balance		5 096 478
	The movement in the provision is reconciled as follows:		
	Opening balance	5 096 478	4 046 087
	Increase based on Output VAT portion of grant funding received	1 101 000	1 050 391
	Total balance at year-end	6 197 478	5 096 478

Refer to note 48.2 for a brief description of the nature of the obligation.

24.08 Library Services

Opening Unspent Balance	-	608 285
Grants Received / (Repaid)	7 340 001	7 002 609
Transferred to Revenue - Operating	(7 185 023)	(7 315 616)
Transferred to Revenue - Capital	(154 977)	(295 278)
Closing Unspent Balance	-	-

The Library Services (Municipal Replacement Fund) Grant is used to pay the salaries of library staff.

48.2 Output VAT on Library Grants

In prior years, all funds received from the Department of Cultural Affairs and Sport (DCAS) relating to the library services were treated as zero rated grants and accordingly no Output VAT was declared on the said funds.

During the 2022/23 statutory audit, the Auditor-General issued a finding that the funds being received from the DCAS are in deed for services being rendered to the Department, as the library function has not been assigned to municipalities. Given the afore-mentioned, it was concluded that the standard VAT rate of 15% be applied, resulting in Output VAT being payable to the South African Revenue Service (SARS).

During the current year, the Municipality requested a Section 41B VAT class ruling from SARS. As at reporting date, no formal ruling has been issued by SARS. Preliminary discussions with SARS indicated that the ruling may not be favourable towards to Municipality. Given this, the Municipality took a conservation approach to recognised a provision in this regard, whereby Output VAT was calculated on funds received for the financial periods from 2018/19 to 2023/24. The afore-mentioned will result in the comparative figures being restated.

The net effect of the above-mentioned were as follows:

- Current Provisions - note 19	Understated	5 096 478
- Government Grants and Subsidies - Operating - note 24	Overstated	(1 050 391)
- Accumulated Surplus - note 48.3	Overstated	(4 046 087)

48.3 Accumulated Surplus

Payables from Exchange Transactions - note 48.1	(141 705)
Output VAT on Library Grants - note 48.2	(4 046 087)
Total	(4 187 792)

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Audited AFS Disclosure 2023/24 *(Case 3)*

Per note 60, the municipality recognised a **contingent liability** as the municipality is still awaiting a ruling from SARS on the matter

In the case of this municipality the classification of the library management fees were still accounted for as **Revenue from Non-Exchange per GRAP 23**

Audited Annual Financial Statements for the year ended 30 June 2024

Notes to the Audited Annual Financial Statements

	2024	2023
60. Contingent liabilities		
Contingency arising out of litigation	18 869 071	42 656 699

Litigation is the process of taking a civil law suit (legal dispute) to Court. A civil case refers to a legal dispute between two or more parties seeking resolution through the civil court system. Civil litigation refers to the legal process of resolving disputes between parties seeking monetary damages, specific performance, or other remedies instead of criminal sanctions. These cases arise from a wide range of issues, including contract disputes, personal injury claims, property disputes, employment grievances, and more.

	2024	2023
Contingency arising out of mediation	250 000	250 000

Mediation is a process by which a mediator assists the parties in a legal dispute by facilitating discussions between the parties, assisting them in identifying issues and exploring areas of compromise.

	2024	2023
Contingency arising out of arbitration	1 000 000	-

Arbitration is a procedure in which a dispute is submitted, by agreement of the parties, to one or more arbitrators who make a binding decision on the dispute. In choosing arbitration, the parties opt for a private dispute resolution procedure instead of going to court.

	2024	2023
Municipal landfill site	-	-

The municipality has a present obligation to rehabilitate the landfill site which stems from licensing agreements 19/2/5/1/B4/45/WL0182/22 issued in terms of the Environmental Conservation Act, 1989 (Act 73of 1989). The obligation is immediately enforceable upon closure of the landfill site. As part of these licensing obligations, the municipality is responsible for post-closure obligations namely, ground water monitoring, decommissioning, monitoring committee and gas monitoring. The duration of the time for the cost to be incurred is contingent on the decision making of the regional director as stipulated in the licence conditions. At 30 June 2024, a decision has not been made by the regional director on the post-closure obligations for the municipality as per the licence agreements, as a result thereof, a reliable estimate of the costs to be incurred cannot be reliable estimated due to the uncertainty of the key events contained within the licencing conditions.

	2024	2023
VAT on library grants	11 808 695	9 868 979

The municipality has approached SARS to provide a VAT ruling in relation to library grants recieved by the transfering department. The current contingency relates to the question as to the services rendered by the municipality in relation to libraries in the municipal area are not part of the muncipalities mandate and consequently, the grant received is therefore potentially not exempt of VAT due to the benefit being for the transferring department. The contingency relates to the outcome of SARS ruling in relation to this item. The amount disclosed is an estimate of the VAT amount, potential

interest and penalties which the municipality may be exposed to.

	31 927 766	52 775 67
Prior period error		
Contingent liabilities previously reported	-	42 906 699
VAT on liabrary grant	-	9 868 979
The municipality has seeked guidance on the treatment of VAT on the library grants and has concluded that a contingency does exist and therefore gives rise to a contingent liability in the prior year as well. The amount in relation to this error is R9 868 979	-	-
	-	52 775 678

Unaudited AFS Disclosure 2024/25

BGR 74 (03 October 2024) *covering VAT treatment of certain supplies of goods or services made by a municipality to a national or provincial government*

Noted improved consistency *in the presentation and disclosure of the matter related to the library function complexity*

The municipalities that recognised the liability have now also ***contingent asset*** *recognised on the potential reprieve of the penalty portion having followed the* ***VDP process****. Note it is* ***limited*** *to the penalty portion and* ***excludes the interest portion***

Liability/Payable	Provision	Contingent Liability	Unknown
8% of portfolio (2 munis)	84% of portfolio (21 munis)	4% of portfolio (1 muni)	4 % of portfolio (1 muni)

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Library Function - Key Considerations

- In response to the communications from the Province, Min E Gondwana issued letter 24 July 2024
- Directive explicitly advised municipalities to "…***seek payment arrangements***"
- This advice is grounded in the **SARS Act No. 34, 1997 (specifically Sections 4(4)(3)(a-b) and 5(2))**, which establishes SARS obligation to comply with Ministerial policy directives
- **NT's Final Response Document on draft Tax Bills (21 Jan 2020)**, which emphasises that SARS policy intent may be derived from secondary aids, such as Budget Speeches, Explanatory Memoranda, and published guidelines
- Given the specific factual matrix the following is raised:
  - **Legal Authority**: The Ministerial directive issued before the AFS submission date, within the framework of the SARS Act mandating SARS compliance with such directives
  - **Tax Nature**: VAT as a self-assessed tax
  - **Reporting Framework**: Compliance with GRAP
- What constitutes the appropriate accounting treatment and disclosure under GRAP standards for a VAT liability where:
  - The liability's existence is confirmed (per self-assessment),
  - A formal Ministerial directive explicitly advises seeking a payment arrangement due to impracticality of immediate full payment, and
  - This directive is received before the AFS reporting date and carries legal authority under the SARS Act

Broader Implications & Closing Insights

Beyond Libraries - The Ripple Effects

- Consider potential VAT **Opportunities as presented by SARS**
- Any **potential points of leverage** you may have when it comes to your VAT matters?
- Refer to:
  - mSCOA Circular 12 – VAT on **pg. 11**
  - MFMA circular 126 - *Budget Circular for the 2024/25 MTREF* **(Section 6.3)**
  - MFMA Circular 129- *Budget Circular for the 2025/26 MTREF* **(Section 5.2.3)**
  - VAT 409 (Issue 7) guide covering fixed property and construction – **Pg. 60**
- ***S20 of the VAT Act*** provides explicit particulars of the requirements of a **tax invoice**

Faculty Alignment - Contract by Representation

AGSA SCA Judgement (671/2020)
Para [12]

" The expression is particularly used in respect of **the phenomenon of representation.** In such a case, a person **(the agent) is authorised by another (the principal) to create, alter or discharge legal relationships between the principal and third parties.**

The essential characteristic of **agency in the form of representation** is that **authority is conferred on the agent to bind the principal to third parties** [J M Silke De Villiers and Macinstosh, The Law of Agency in South Africa, 3 ed (1981) at 38 39."

SARS BGR 4 – Issue 4 (June 2025)
General note 11

*"The essential characteristic of agency in the **form of representation** is that **authority is conferred on the agent to bind the principal to third parties**.*
*A **contract of mandate** is a contract by which the principal and the agent create rights and obligations **only** between them. **It does not involve legal relationships with third parties.**"*

SARS Interpretation Note 42 (December 2016)

- *"The VAT Act confirms the common law relationship between the principal and agent and prescribes the VAT consequences of this legal relationship."*
- *"The principal must **grant the agent the necessary authority to act on behalf of the principal**. Authority is a unilateral act by the principal which **empowers the agent to enter into, alter or terminate legal relationships** between the principal and third parties."*

GRAP
GRAP 109.05

*A **principal-agent arrangement** results from a binding arrangement in which **one entity (an agent)**, **undertakes transactions with third parties on behalf**, **and for the benefit of, another entity (the principal).***

Method statement for Principal/Agent Arrangements

1. Obtain the **binding agreement;**
2. Thereafter, **establish who** the **contractual parties** are;
3. Determine the rights and obligations of the contractual parties with reference to the binding agreement and with reference to all the contractual parties **&**
4. Lastly, evaluate and conclude with which party the **commercial risk** resides.

The commercial risk can never reside with the agent if there is a "genuine" principal/agent arrangement.

N.B. *For a principal-agent arrangement to exist (in the context of the supply of goods and services on behalf of a principal), there must be goods sold, or a service rendered to a third party on behalf of the principal by the agent, which leads to entering, altering, or terminating legal relationships between the principal and third parties.*

N.B. *Procurement must be considered carefully. If a "genuine" principal/agent relationship exists, can the agents use their own SCM procurement processes/policies?* ***Consider IE effects!!***

Conclusion

- Importance of how we transact to ensure we uphold the requirements of ***S217 of the Constitution*** is key inter alia
- When ever we transact, we ***must consider the VAT as well as mSCOA considerations***
- E.g., MFMA Circular 131 provides guidance for municipalities on making unrequited transfers to NGOs and NPOs
  - Should NPOs be registered for VAT, for example?
  - **VAT 414 guide** – A general guide concerning the application of the VAT Act in respect of associations not for gain and welfare organisations in South Africa.

Thank you