A CRITIQUE OF THE DETERMINATION OF A COMPOSITE SUPPLY FOR VAT PURPOSES IN SOUTH AFRICA: LESSONS FROM SELECTED COUNTRIES

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1 Introduction

To determine, for the purposes of the Value-added Tax Act ('VAT Act')[1] whether a supply consists of a composite supply or several distinct supplies is paramount. Amongst other reasons, it impacts on how the entire supply should be treated under the VAT Act (i.e. standard, exempt or zero-rated). The treatment of the supply not only affects the applicable tax rate, but it also impacts the value-added tax ('VAT') claimable or payable when acquiring or selling the supplies. The incorrect treatment of the supply puts the taxpayer at risk since the tax authority may raise reassessments and impose penalties. Therefore, where a supply entails the supply of goods or services or both, it is essential for a vendor to correctly treat the transaction to avoid these repercussions.

The aim of this paper is to illustrate that the South African (SA) approach to determining whether a separate part is made is not in line

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1 Act 89 of 1991.

with the international approach. The domestic approach appears to ignore essential elements that are widely accepted when deciding if a supply is single or composite. This paper argues that this approach may in some cases yield unfavourable results in term of VAT.

To provide more clarity and avoid the unintended unfavourable results that may ensue, the European VAT ('EU VAT'), Canadian, Australian and New Zealand systems, collectively referred to as 'CAN countries', in addition to the legal precedent the tax authorities have provided as supplementary guidelines directing a taxpayer on how to treat a supply with several supplies.

The purpose of this paper is to illustrate South African shortcomings in determining whether a separate part of the composite supply is made or not. The comparative analysis is conducted with an aim of gaining the lessons so to improve the South African position.

The discourse limits itself to a composite supply supplied by one vendor to the consumer as oppose two or more vendors making a supply to a consumer. Furthermore, this article does not deal with two or more supplies made to various recipients.

The paper is structured as follows; Part I, briefly discusses the meaning of the composite supply; Part II, provides the South African approach to composite supply; Part III, outlines how the EU and CAN jurisdiction's VAT systems treat the composite supply; Part IV, points out the shortcomings of the South African approach to the treatment of the composite supply; Part V, outlines the recommendations may be implemented so to align the South African approach with the international perspective.

2 The meaning of the composite supply concept

The term 'composite supply' is not defined in the South African VAT Act. Neither the EU VAT nor CAN countries define the term. In the CAN countries, the concept of composite supply is also known as the 'incidental, combined, mixed or composite'[2] supply. Although the composite supply is not defined, the relevant indirect tax acts make provisions which specifically deals with the composite supply transactions.

Generally, the concept of composite supply originates from the supply that entails more than one items which are supplied together for VAT purposes. In such a supply, generally one supply is the taxable

2 E.g. sec 138 of the Canadian Excise Tax Act 1985 (thereafter 'ETA') refers to as 'incidental' supply, sec 139 refers to 'mixed' supply, sec 168(8)(*a*) refers to as 'combined supply', while the Australian GST Ruling 2001/8 refers to as 'mixed or composite' supply.

component and the other part is a non-taxable component.[3] The component that constitutes the taxable supply will be taxed according to the applicable VAT rate (i.e. standard, zero or exempt rate). The part that forms the non-taxable supply will be excluded from VAT.

Notably, each jurisdiction has a unique legislative context. However, there appears to be consensus on the meaning of the composite supply concept. The understanding is that the composite supply is a supply with more than one component partially taxable and partly non-taxable[4]. Due to the absence of the universally and internationally accepted composite supply definition, for this paper the composite supply refers to a supply that consists of two or more taxable or non-taxable supplies whether of goods or services or both supplied together by the same registered vendor to a recipient. The supply will potentially attract VAT at a different rate such as the standard, zero and exempt rates.

The discussion that follows set out the South African treatment of the composite supply.

3 South African treatment of the composite supply

3.1 Legislative framework

Section 10(22) of the VAT Act deals with a composite supply that is partly taxable and partly non-taxable. Here, the portion attributable to a taxable supply attracts VAT. Thus, this section requires that the part representing the taxable and non-taxable supply be treated accordingly.

Section 8(15) of the VAT Act deals with a supply that is partly taxable at standard rate and partly taxable at zero-rate. The section deems each part in the composite supply to be a separate supply. The standard rate applies to the portion representing the standard rate supply while zero-rate applies to the part attributable thereto.

3 *Virgin Atlantic Airways Ltd v Customs and Excise Commissioners, Canadian Airlines International Ltd v Customs & Excise Commissioners* [1995] BVC 93. In this matter, the air-carrier company sold aeroplane tickets to its customers. The services involved were amongst other services, the aeroplane ticket (which was zero-rated) as well as a limousine service (which was standard rated).

4 *Auckland Institute of Studies Ltd v CIR* (2002) 20 NZTC 17,685; *College of Estate Management v Customs and Excise Commissioners* [2005] BVC 704; *Commissioner of Taxation v Luxottica Retail Australia Pty Ltd* [2011] FCAFC 20; O Henkow 'Defining the tax object in composite supplies in European VAT' (2013) 2 *World Journal of VAT/GST Law* 189.

Considering the abovementioned, the supply that is made under the relevant provision is deemed to be a separate supply even though the supplies emanate from a combined supply.

3.2 Case law

3.2.1 ABC (Pty) Ltd v Commissioner for the South African Revenue Service[5]

In this case, a taxpayer (a South African resident) supplied a non-resident with advertising and promotional services. As per the service contract, the taxpayer had an exclusive right (i.e. trademarks, intellectual property, equipment, packages and labels) to market, distribute and promote the non-resident's alcoholic products in SA. As part of the agreement the taxpayer integrated and synergetic marketing strategy, the taxpayer supplied the promotional products to the customers to enhance the services,[6] which were distributed and consumed in South Africa. The entire service was a zero-rated supply as it made up an exported service that is zero-rated for VAT purposes. The tax commissioner argued that the promotional products made up a separate supply that must be taxable at the standard rate. The question was whether the taxpayer supplied a composite service or two independent supplies (i.e. advertising and promotional services and promotional goods).

The Tax Court held that this made up two separate supplies since the promotional goods were distributed and consumed in the Republic, whereas the advertising and promotional service was zero-rated as exported services supplied to the non-resident, not present in the country at the time the services were rendered, and not related to movables in the Republic.[7]

3.2.2 Diageo South Africa (Pty) v Commissioner for South African Revenue Service[8]

On appeal, the Supreme Court of Appeal had to determine if the court *a quo* reached a correct decision in that the promotional goods were taxable as a separate supply. The SCA confirmed that the promotional

5 *ABC (Pty) Ltd v Commissioner for the South African Revenue Service* 2018 JOL 40512 TC (thereafter '*ABC v CSRS*').

6 The term promotional products refer to goods given away free of charge by the SA resident in the Republic as the means to build and maintain the brand image of the non-resident. These products include alcoholic products for sampling and branded giveaways items such as glasses, optics, towels, beer mats, lanyards, keyrings, T-shirts, aprons, caps and the like.

7 Sec 11(2)(l) of the VAT Act.

8 *Diageo South Africa (Pty) v Commissioner for South African Revenue Services* 2020 JDR 0555 (SCA) 34 (thereafter '*Diageo SA*').

products were taxable as the independent supply since the promotional goods were not exported and thus consumed in SA.[9]

The importance of the *Diageo SA* decision is that the SCA set out the jurisdictional requirements must be present before section 8(15) applies. According to the court, these requirements dictate that a separate part of the combined supply will be made for VAT purposes. The section 8(15) jurisdictional requirements are as follows;[10]

a) there must be a 'single supply' of two or more types of goods or services or a combination of goods and services;
b) one consideration must be payable as only a single supply is made; and
c) the circumstances must be such that if the supply of the goods or services or both had been charged for separately, part of the supply would have been standard rated, and part zero-rated.

The SCA found that all these requirements were present in the *Diageo SA* case. As a result, the promotional goods constituted a separate part which ought to be taxable. To determine if a separate part is supplied the question is whether a part of the composite supply falls within the ambit of the deeming provisions in section 8(15).[11] If the part of the composite supply fall within section 8(15), the next step is to apply the jurisdictional requirements. The SCA in *Commissioner South African Revenue Service v British Airways Plc* enunciated the significance of this section as follows;

> The section does no more than apportion the rate at which the vendor is required to pay the tax that is levied by section 7 when the vendor has supplied different goods or services as a composite whole.[12]

Section 7(1) of the VAT Act, known as the imposition clause, states that VAT is levied on the supply of goods, services and importation. As per imposition clause, it follows that each supply is deemed as a separate part.

As per *Diageo SA* and *ABC v CSARS*, the enquiry is whether a taxpayer has supplied a separate part, even though combined into a single supply. It appears therefore that South Africa does not concern itself with the question of the composite supply per se. The question seems to be whether the part of the combined supply is a separate

9 *Diageo SA* (n 8 above) para 21.
10 *Diageo SA* (n 8 above) para 13.
11 *Diageo SA* (n 8 above) para 17.
12 *Commissioner South African Revenue Service v British Airways plc* 2005 4 SA 231 (SCA) para 13. The taxpayer is an international carrier service provider who supplies its customers with international transport service ('ITS'). The ITS is taxable as a zero-rated service under VAT. ITS included amongst other charges, the airport services, that the British Airways (thereafter 'BA') obtained from the Airport Company Ltd (thereafter 'AC Ltd') (i.e. the airport operator). SARS argued that the airport service formed a separated supply, thus taxable individually. SARS submitted that the airport service needs to be deemed as a separate supply from the ITS. The question was whether the airport service made up a separate part that must be treated as a separate supply under sec 8(15).

supply or not. In terms of section 8(15), the part of the composite supply will be regarded as a sperate part if all the jurisdictional requirements are met.

In *Taxpayer v Commissioner for South African Revenue Services*,[13] the taxpayer supplied a money-transfer service within the Africa continent. The taxpayer supplied both the taxable and exempt supplies. The court accepted that the taxpayer supplied parts there were identifiable. The VAT was payable on the part that was attributable to the taxable supply in terms of section 10(22). As for section 10(22), it appears that there will be a separate part where the taxpayer makes a supply that comprises both the taxable and non-taxable part. The VAT is payable on the consideration attributable to the taxable supply.

Clearly the above envisages that SA considers the supply of each part as a separate independent part. Whether parts are supplied together in the combined supply seems irrelevant. It can be argued that SA follows the distinct element approach when imposing the VAT on the supply.

The next section examines the treatment of the composite supply that is adopted by the EU VAT as well as CAN countries.

4 The international approach to the treatment of composite supply

This part of the paper shows how other jurisdictions determine if a separate part is made or not.

4.1 The EU VAT system

The EU VAT system has a long-standing history on the treatment of the composite supply transactions. Dating back to 1979 in the decision of *Nederlandse Spoorwegen v Staatssecretaris van Financiën*,[14] the question before the European Court of Justice ('ECJ') was whether the 'cash-on-delivery price' charged by the carrier to deliver the customers' goods to the consignee constituted an ancillary fee to the transport service price collected on the delivery of goods. In this case, the cash-on-delivery fee was taxable under VAT whereas the transport service price was exempted from VAT. The court developed and applied the principle of *accessorium sequitur*. The *accessorium sequitur* principle states that an accessory thing does not lead to but

13 *Taxpayer v Commissioner for South African Revenue Services* 2018 2 All SA 478 (WCC) 81 SATC 79.

14 *Nederlandse Spoorwegen v Staatssecretaris van Financiën* 126/78 [1979] ECR 02041.

rather accedes to the principal thing to which it is accessory.[15] The ECJ found that the cash-on-delivery fee constituted an ancillary or integral to a single price of the transport service price. According to the court, the cash-on-delivery fee was an accessory charge to the principal service which was a transport service fee. As a result, the cash-on-delivery acquired the tax consequences of the principal service that was exempted under VAT. Since then, this principle has been applied constantly in cases dealing with the composite supply in the EU VAT system.[16]

The point of departure in every matter that deals with supply for VAT purposes, whether it is a single or composite supply, is article 2(1) of the Sixth VAT Council Directive, 2006/112/EC ('Sixth VAT Directive').[17] Article 2(1) allows the imposition of VAT on the supply of goods or service or importation payable by the vendor. The ECJ has held that following this provision every supply is deemed to be supplied independently,[18] unless the exceptions as discussed in *Card Protection Plan Limited v Customs & Excise Commissioner* exist.[19]

In the *CPP Ltd* case the ECJ was confronted with the question of whether the supply consists the several parts constituted a composite supply or several separate supplies. *In casu*, a taxpayer supplied its customers with an insurance policy cover. The insurance policy covered the customers against the financial loss, inconvenience resulting from the loss or theft of their cards or loss of items such as car keys, passports and insurance documents (exempt supply) as well as maintenance of the holders' card registration number (taxable supply). Since 1983 the tax authorities have been exempting the entire insurance policy supply under VAT. Notably, in 1990 the revenue authority applied a standard rate in the supply of insurance policies. The tax authority argued that CPP Ltd supplied two distinct supplies that ought to be apportioned by applying a standard rate on the taxable supply portion.

Consequently, the ECJ had to decide if CPP Ltd supplied a composite supply or two distinct supplies. In deciding if a taxpayer supplies a composite or several separate supplies, the court set out the test as follows;[20]

15 Henkow (n 3 above) 196.
16 Henkow (n 3 above) 189.
17 *Airtours Holidays Transport Limited v Commissioners for Her Majesty's Revenue and Customs* [2016] UKSC 21 paras 13, 19.
18 *Purple Parking Ltd, Airparks Services Ltd v the Commissioner of Her Majesty's Revenue Service* (ECJ 2012) (Case C-117/11) paras 26–31, (thereafter '*Purple Parking* case'); *Field Fisher Waterhouse LLP v Revenue & Customs Commissioners* (Case C-392/11) [2012] BVC 292 paras 14–19.
19 *Card Protection Plan Limited v Customs & Excise Commissioner* [2001] 2 All ER 149 (HL) (thereafter '*CPP* case').
20 *CPP* (n 19 above) par 29.

a) every supply of service must normally be regarded as distinct and independent;
b) however, a supply which comprises a single service from an economic point of view should not be artificially split, so as not to distort the functioning of the VAT system;
c) essential features of the supply must be considered in determining if the vendor supplies a typical customer with several distinct principal services or with a single service.

Kapteyn J further indicated the circumstances which will most likely point towards a composite supply. The composite supply will be when one or more goods or services serve as a principal component, by contrast, while the other goods or services constitute ancillary components which will share the tax consequences of the principal component.[21] It was held that an ancillary component is that part of the composite supply that does not constitute an aim itself rather enhance the enjoyment of the principal component.[22] In this circumstance, a single price paid by the customers is not a decisive factor. However, in some circumstances, there may be multiple components that are supplied for a single price, in such cases, that single price may point to toward the composite supply. In other cases, a single price may be paid for the supply that consists of multiple parts. However, if the facts dictate that the customer intended to pay for more than one component then it will be necessary to identify that part of the supply which will remain exempt.[23]

The ECJ has applied the *CPP* test in several subsequent cases when dealing with the composite supply. For instance, in the *Purple Parking* case.[24] In this matter, the taxpayer supplied its customers with the 'off-airport park-and-ride' service where the customers could park their cars at a safe parking operation and board a bus or mini-bus provided by Purple Parking to the airport. The question before the court was whether the supply of the 'off-airport park-and-ride' service and transport service to and from the airport constituted a composite service or two distinct services.

The court applied the *CPP Ltd* criteria and concluded that the two services formed a composite service for VAT purposes. Amongst other reasons, the court noted that the taxpayer charged a single price for the parking service. More so, the taxpayer only charged the customers based on the duration or length of the time parked (some customers could park their cars for several days on average),[25] as opposed to the

21 *CPP* (n 19 above) par 30.
22 As above.
23 See the apportionment method in this regard, ECJ, Joined Cases C-308/96 & C-94/97, *Commissioners of Customs and Excise v T.P. Madgett, R.M. and the Howden Court Hotel* [1998] ECR I-6229 paras 45-46.
24 *Purple Parking* (n 18 above); *Město Žamberk v Finanční Ředitelství v Hradci Králové* ECJ, Case C-18/12, [2013] ECR I-0000.
25 *Purple Parking* (n 18 above) paras 33-36.

number of customers transported to and from the airport.[26] According to the court, additional transport service to and from the airport was an inevitable supply as the parking was located at a distance from the parking operation, accordingly, the transport service was just a completion of the supply of the principal parking service.[27] Additionally, in *Finanzamt Burgdorf v Manfred Bog, CinemaxX Entertainment GmbH & Co. KG v Finanzamt Hamburg-Barmbek-Uhlenhorst, Lothar Lohmeyer v Finanzamt Minden and Fleischerei Nier GmbH & Co. KG v Finanzamt Detmold*,[28] the ECJ had to decide if the supply of beverages (taxable supply) supplied together with the food or meals prepared for an immediate consumption which was taxed at a reduced rate constituted a composite supply or two independent supplies.[29] The court applied the *CPP Ltd* test to conclude that from the consumer's standpoint, this supply constituted a composite supply.

It is also noted that these principles have also been adopted by the EU Member States when face the question of composite supply. The former EU Member State, the United Kingdom ('UK') courts have applied the test consistently in several cases. For example, in the *British Airways* case,[30] the Court of Appeal found that the provision of in-flight catering was, in substance and reality, an integral part of the supply of air transportation.[31]

Therefore, the above proves that this test forms a foundation of the EU VAT system in determining if a supply consists of a composite supply or several individual supplies. In what follows is the demonstration of how the CAN countries treat the composite supply.

4.2 Canadian system

The composite supply provisions are provided in three sections of the Canadian VAT Act. These sections are 138, 139 and 168 which will now be discussed.

26 *Purple Parking* (n 18 above) para 34.
27 *Purple Parking* (n 18 above) paras 12-22.
28 *Finanzamt Burgdorf v Manfred Bog; CinemaxX Entertainment GmbH & Co. KG v Finanzamt Hamburg-Barmbek-Uhlenhorst; Lothar Lohmeyer v Finanzamt Minden and Fleischerei Nier GmbH & Co. KG v Finanzamt Detmold* (Joined Cases C-497/09, C-499/09, C-501/09 & C-502/09) [2011] ECR I-01457 (thereafter '*Bog & Others*').
29 *Bog & Others* (n 28 above) paras 23-24.
30 *British Airways plc v Customs and Excise Commissioners* (1990) 5 BVC 97 (thereafter '*British Airways*').
31 *British Airways* (n 30 above) paras 102-103 notes that '…Catering facilities are part of, and integral to the transportation in that degree of comfort which British Airways have decided is commercially appropriate and indeed necessary to attract passengers'.

4.2.1 Incidental supply

The first provision is the 'incidental supplies' provision, in section 138 of the Canadian Excise Tax Act. This section states that:

> A particular property or service is supplied together with any other property or service for a single consideration, and it *may reasonably* be regarded that the provision of the other property or service is incidental to the provision of the particular property or service, the other property or service shall be deemed to form part of the particular property or service so supplied.[32]

It appears from this section that, an ancillary component is part of the principal supply if the facts dictate that such part must be regarded as an incidental thereto. Therefore, according to this provision, due diligence must be given to the entire facts so to determine if one part constitutes an incidental part of the principal supply. It follows, thus, thereafter it is established that there is an incidental part as well as the principal part, the tax consequences of the principal part are imputed to the incidental part.[33] Put differently, the accessory component acquires the tax implications of the principal component.

The difference between section 138 and section 8(15) is essential because the Canadian law appears to follow a factual analysis in identifying if the taxpayer supplies the ancillary and principal part. It is unnecessary to deem each component as a separate supply if the circumstances in which the composite supply raise point towards the supply of the incidental and principal part. The South African approach appears to follow only the legal context under the distinct element approach. This is arguably irrespective of whether the parts appear as an ancillary or principal part each part is deemed a separate supply. As per South African perspective, the ancillary and principal part acquires the VAT consequences under appropriate rates.

4.2.2 Mixed supply: Financial service

The second composite supply provision is found under section 139 of ETA. Section 139 specifically deals with the financial properties or services supplied together by the same VAT vendor to the same recipient. According to the section, where more than one financial service is supplied together with one or more other services that are not financial services for a single consideration, in the ordinary course of financial service, each supply would be greater than 50% of the total of all amounts if supplied separately, the supply shall be deemed to be a single supply of financial service or property.

32 Excise Tax Act R.S.C.,1985, c. E-15 (thereafter 'ETA').
33 *CPP* (n 19 above) para 30.

This situation may be seen when a financial institution obtains the goods or services from the third party to supply such goods or services as part of a single supply of financial goods or services.

Illustration: A

Big Investment Bank (Pty) Ltd ('BIB') renders financial advice to the directors of the Big Money Co ('BM Co.') concerning the financial investment in the local financial and foreign financial market. Since the BIB does not have an experience of the foreign trade, BIB acquires the foreign investment advice from the Millionaire Investment Bank (Pty) Ltd (MIB Ltd) that is experienced on the foreign financial market.

Assume that the local or foreign investment service is greater than 50 per cent of the total amount generated by BIB if it is supplied individually. Although it appears that the BIB has applied two financial investment services to the directors of MB Co, however, according to section 139 the supply is deemed to be a single composite supply of financial service.

4.2.3 Combination supply

Section 168 of ETA which states that;

> where a supply of any combination of service, personal property or real property […] is made and the consideration for each element is *not separately identified*,
>
> (i) where the *value* of a particular element can reasonably be regarded as exceeding the value of each of the other elements, the supply of all of the elements shall be deemed to be supply only of the particular element; and
>
> (ii) in any other cases, the supply of all the elements shall be deemed
>
> (a)where one of the elements is real property, to be supply only of real property; and
>
> (b)in any other case, to be a supply only of service.

This provision appears to apply generally to the composite supply that does not fall under section 138 or section 139 of ETA. The operative words from section 168 seem to be that 'element is not separately identified' as well as the value of either supply can 'reasonably' be inferred to exceed the value of the other component that is involved. The point of departure is whether it is factually impossible to identify which part constitutes the ancillary or principal part. If it is impossible, therefore it must be considered if it can be determined on the reasonable basis that the value of either the goods or services is greater than the other part that is supplied with. Therefore, the component appears to have a lesser value will accede to the component that has a greater value.

Also, the Canadian tax authority supplemented the above existing rules with further guidelines that the taxpayers may use to ascertain if the taxpayer has supplied one supply or two supplies.

4.2.4 General Guidelines to Composite Supply

The Canada Revenue Agency ('CRA') issued the GST/HST Policy Statement as a guide to the treatment of composite supply.[34] Herein CRA maintains that its position in determining if a supply consists of a composite supply or several distinct elements is based on the analysis of each fact. The policy sets out the three steps approach to be applied in ascertaining if the supply is single or more than one supply. As per the policy, the guiding principles are as follows;[35]

a) every supply should be regarded as distinct and independent.
b) a supply that is a single supply from an economic point of view should not be artificially split.
c) there is a single supply where one or more elements constitute the supply and remaining elements serve only to enhance the supply.

It is also noted that these principles are also relevant where it is already determined that in fact, there are separate supplies for a single consideration, but one supply is incidental to the other.[36] The CRA explicitly provides that due to a variety of circumstances in both traditional and electronic commerce which affect the determination, it is difficult to provide guidance that covers every eventuality. Accordingly, this justifies the Canadian approach to the treatment of a composite supply.

4.3 Australian System

On 1 July 2010, the Australian Taxation Office ('ATO') has issued an amended tax ruling, the GSTR 2001/8,[37] which deals with a supply that includes a taxable and non-taxable part under A New Tax System (Goods and Services Tax) Act.[38] Relevant in this discussion is section

34 Canada Revenue Agency 'Single and Multiple Supplies: GST/HST Policy Statement P-077R2' 26 April 2004 https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/p-077r2/p-077r2-single-multiple-supplies.html (accessed 23 March 2020).

35 See also FCA, *Hidden Valley Golf Resort Assn. v R.* [2000] G.S.T.C. 42 paras 20, 28-29; *TCC, Camp Mini-Yo-We Inc. v R.* [2006] G.S.T.C. 154 paras 6-11; *TCC, Great Canadian Trophy Hunts Inc. v R.* [2005] TCC 612 para 25.

36 R Butcher *Value-added taxation in Canada: GST, HST and QST* (2009) 57; S Conese 'The EU VAT treatment of composite supplies: evolution trends and critical points' LLM thesis, *University of Tilburg* (2017) 58.

37 Goods and Services Tax Ruling 2001/8: 'Goods & services tax: apportioning the consideration for a supply that includes taxable and non-taxable parts' (thereafter 'GSTR 2001/8') https://www.ato.gov.au/law/view/document?docid=GST/GSTR20018A3/NAT/ATO/00001&PiT=20120411000001 (accessed 29 October 2019).

38 A New Tax System (Goods and Services Tax) Act 1999, (thereafter 'GST Act').

9-75 that deals with the value of entirely or fully taxable supplies, and section 9-80, that deals with the supplies which are partly taxable and partly either GST- free or input taxed.[39] Amongst other purposes, the GSTR 2001/8 describes the characteristics of a supply that contains the taxable and non-taxable parts. It refers to such a supply as a 'mixed supply'. The ruling also describes the features of a supply that appears to have more than one part but essentially it is a supply of a single thing. This type of supply is referred to as a 'composite supply'.[40]

4.3.1 Mixed supply

Unlike Canada, the question asked in Australia is whether the composite supply should be regarded as a mixed or composite supply. In terms of the GSTR 2001/8, a mixed supply is a supply that must be separated or unbundled as it contains separately identifiable taxable and non-taxable parts that need to be individually recognised.[41] According to this definition, the supply with the 'separately identifiable' taxable and non-taxable items will be regarded as a mixed supply for VAT purposes. As a result, the tax consequence of the mixed supply is that each part will be treated as supplied individually from each other. It follows that different tax rates will apply.

4.3.2 Composite supply

Composite supply is defined as the supply that contains a dominant part and often includes something integral, ancillary or incidental to that part.[42] Under the composite supply, consideration is given to the most dominant component. The ancillary parts acquire the tax consequences of the most dominant component. As such the whole supply will be treated as a single supply, even though the supply entails more than the component.[43] If the principal part is a taxable supply the entire supply including the incidental parts will also be taxable. Conversely, if the principal part is non-taxable, then the whole supply will be non-taxable including the incidental parts.

39 Input-taxed refers to the supply that is not subject to output tax, but the taxpayer is also not entitled to an input tax credit for tax on any acquisitions to the extent that the acquisition relates to the making of input-taxed supplies. this is equivalent to the exempt supplies in SA. The rendering of the financial supplies is an example of the input taxed or exempt supplies.
40 GSTR 2001/8 (n 37 above) 2 paras 1-6.
41 GSTR 2001/8 (n 37 above) 4 para 16.
42 GSTR 2001/8 (n 37 above) 5 para 17.
43 As above.

4.3.3 Case Law

Australian courts have in several cases called to determine whether the supply with several supplies constitute a mixed or composite supply. For instance, in *Saga Holidays v Commissioner of Taxation*[44] the court had to determine if a portion of the accommodation element that related to accommodation provided in Australia and sold as a package constituted a mixed or composite supply. Stone J concentrated on the 'social and economic reality' of the supply. It was found that the accommodation component that included several parts in addition to the right to occupy a room was a single supply which was properly characterised as a supply of real property, consequently, it was a composite supply.[45] In *Commissioner of Taxation v Luxottica Retail Australia Pty Ltd*[46] the Federal Court of Australia ('FCA') had to determine if the supply comprised the prescription lenses fitted into frames for glasses and sunglasses (i.e. the frame and a pair of lenses) was a mixed or composite supply.

The FCA noted that the supply entailed the sunglasses and lenses prescription may be purchased as separate items. However, a common-sense approach that was comfortable with the 'practical business tax'[47] outcome requires that the supply be to regard a composite supply of the pair of spectacles.[48] Lastly, in *Re Food Supplier and Commissioner of Taxation (Food Supplier)*,[49] the court found that the supply of the promotional items supplied together with food such a jar of coffee (main item) and a mug (promotional item) constituted a mixed supply, as such each part was taxable individually.

The Australian system appears to focus on the element of the supply that is combined or disaggregated to alter the nature of the supply from taxable or non-taxable or vice visa.[50] Since Australia considers the GST a 'practical business tax', the suppliers must determine if they have supplied one supply or two supplies.[51] The ATO also maintains that the distinction between the mixed or composite

44 *Saga Holidays v Commissioner of Taxation* 2006 ATC 4841 (thereafter '*Saga Holidays*').
45 *Saga Holidays* (n 44 above) para 43.
46 *Commissioner of Taxation v Luxottica Retail Australia Pty Ltd* [2011] FCAFC 20 (thereafter '*Luxottica*').
47 The GST is classified as a 'practical business tax' since according to several cases, the supplier as opposed to the consumer the collection of the tax. The tax is collected by the suppliers at the various stage of the supply chain. Last, in exceptional cases, where it is practicable to 'quarantine business' from the ultimate tax burden, the supplier bears the full burden of the GST. See generally *HP Mercantile Pty Ltd V Commissioner of Taxation* (2005) 143 FCR 553 para 66; *Sterling Guardian Pty Ltd v Commissioner of Taxation* (2005) 220 ALR 550 para 39; *Saga Holidays* para 30
48 *Luxottica* (n 46 above) paras 13-15.
49 *Re Food Supplier and Commissioner of Taxation* (2007) 66 ATR 938.
50 A Schenk & V Thuronyi *et al Value added tax: a comparative approach* (2015) 129.

supply is a question of 'fact and degree'. As such, in deciding whether a supply comprises more than one part, the common-sense approach must be adopted.[52]

4.4 New Zealand system

The New Zealand VAT system appears to be well developed in that it has a unique codified procedure to the treatment of the composite supply. The relevant provision is section 5(14) of the New Zealand Goods and Services Act states as follows:

> If a supply charged with a tax under section 8 [standard rate], but sections 11, 11A, 11B, 11AB, 11B or 11C [zero rates] requires part of the supply to be charged at the rate of 0%, that part of the supply is treated as being separate supply.[53]

As per section 5(14) of the GST Act, where a supply consists more than one supply, one taxable as the standard rate supply and the other as a zero-rate supply, each part is treated as a separate supply. As such, the standard and zero rates apply to different parts accordingly.

Also, the Inland Revenue ('IR') has provided an Interpretation Statement that is detailed on the 'single supply' or 'multiple supplies'.[54] According to IS 18/04, first is to consider if the so-called 'boundary issues' arise or not when dealing with the composite supply. Boundary issues primarily arise where some supplies in the composite supply are subject to VAT at different GST rates (i.e. exempt, standard, zero rates or not subject to GST).[55] Boundary issues mean that it must first consider if the entire composite supply falls within the specific deeming provisions of the GST Act. Essentially, if the supply falls within one of these specific provisions, irrespective of how the composite supply may be treated under the ordinary principles, the specific provision overrides ordinary rules.[56] The specific provisions are as follows;[57]

a) Section 5(14B) — for rights embedded in shares;
b) Section 5(20) — for warranty services provided to a non-resident warrantor; and
c) Section 5(15) — for supplies including residences.

51 GSTR 2001/8 (n 37 above) 41 para 110; *ACP Publishing Pty Ltd v Commissioner of Taxation* [2005] FCAFC para 2.
52 GSTR 2001/8 (n 37 above) 6 para 20.
53 New Zealand Goods and Services Act 141 of 1985 (thereafter 'GST Act').
54 Inland Revenue, Interpretation Statement: IS 18/04 — *Good and Services Tax— Single Supply or Multiple Supplies* (2018), (thereafter 'IS 18/04') https://www.classic.ird.gov.nz/technical-tax/interpretations/2018/interpretations-2018-is1804.html (accessed 25 March 2020).
55 IS 18/04 (n 54 above) 5 para 14.
56 IS 18/04 (n 54 above) 6 para 20.

If the composite supply does not fall within one of the specific inclusions, then the inquiry continues to consider the main test of the single or multiple supplies. In New Zealand, the High Court judgment in *Auckland Institute of Studies Ltd v CIR*[58] sets out the principles that must apply in determining whether there are single or multiple supplies. According to these principles the IR issued the supplementary guidelines that are based on these principles. As the Canadian guidelines, the Inland Revenue guidelines mirror the *CPP Ltd* criteria as discussed in the following paragraphs.

4.4.1 The true and substantial nature test

The essential question is what is the true and substantial nature of what is supplied to the recipient? The Revenue Commissioner considers the phrase 'the true and substantial nature' as the consideration given to the consumer perspective. In other words, consideration must be given to what the recipient paid for, and the supply that has received for the consideration paid. This consideration is what is provided to the typical consumer based on the objective assessment of all the facts.[59]

4.4.2 The relationship between the elements supplied test

In this regard, the question is the relationship between the elements supplied. The relationship refers to whether a part that is supplied is an integral part of, ancillary or incidental to the essential elements of the entire supply. This is largely depending on the facts of each case.[60] In the *Auckland Institute case* the court had to determine if the supply of the pre-arrival services were ancillary or incidental to

57 IS 18/04 (n 54 above) paras 19-20. Sec 5(14B) requires that if part of a supply of a share in the supply of a right to receive supplies of goods and services that are not exempt supplies, the supply of the right is treated as being a separate supply; sec (20) also requires the supply of goods and services to the final consumer to be treated as the service of remedying a defect to the non-resident warrantor. Sec 5(15) further deems a supply that includes a principal place of residence to be a separate supply from the supply of any other property included in the supply. Sec 5(15) applies to a dwelling that has been rented out by the vendor exclusively for accommodation for at least the preceding five years. For example, when a farm (which includes the farmer's house and its surrounding curtilage) is sold, sec 5(15) provides that the vendor's supply of the farmer's house and curtilage is a separate supply from the supply of the remainder of the farm. The GST treatment of each supply is determined separately.

58 *Auckland Institute of Studies Ltd v CIR* (2002) 20 NZTC 17,685 (thereafter '*Auckland Institute*').

59 *Wilson & Horton Ltd v C of IR* (1995) 17 NZTC 12,325; *British Airways plc Customs & Excise Commissioner* [1990] STC 643 (CA);*Auckland Institute* (n 58 above) paras 44-45.

60 *Customs and Excise Commissioners v United Biscuits (UK) Limited* [1992] STC 325; *Customs and Excise Commissioners v Wellington Private Hospital Ltd* [1997] STC 445 (EWCA) 462; *College of Estate Management v Customs & Excise Commissioners* [2005] UKHL 62.

the principal supply of tuition services? Hansen J ruled that the pre-arrival services constituted the ancillary parts to the supply of tuition services. The court held that this was so because the pre-arrival services facilitated the students undertaking a course of study.[61]

College of Estate Management v Customs and Excise Commissioners stated that the mere fact that the supply of the printed materials could not be described as an ancillary did not mean that it was to be regarded as a separate supply for tax purposes.[62] The question was whether, for tax purposes, these were to be treated as separate supplies or merely as elements in some over-arching supply.[63] *Metropolitan International School v Revenue and Customs Commissioners* succinctly explained the significance of the ancillary.[64] The court held that an element, not an end itself ranked as an ancillary, and ancillary component generally contributed to the better enjoyment of the principal element.[65] It follows that an ancillary part does not constitute a supply itself. As such, it acquires the tax consequences of a principal part.

4.4.3 Whether it reasonable to supply the element separately test

Is it reasonable to serve the element into separate supplies? According to the IS 18/04 this test requires taking an overall view without over-zealous dissection and consider the essential (or dominant) purpose of the supply.[66] As pointed out in the *CPP* case, similarly in the *Auckland Institute* case, the court stated that the supply that comprises a composite service from an economic point of view should not be artificially split.[67]

In this regard, the court cited the judgment *Customs and Excise Commissioners v British Telecommunication plc* in that:

> …it is clear that the fact that one 'package price' is charged without separate charge for individual supplies being specified does not prevent there being two separate supplies for VAT purposes. In my opinion, the fact that separate charges are identified in a contract or on an invoice does not on a consideration of all the circumstances necessarily prevent the various supplies from constituting one composite transaction nor

61 *Auckland Institute* (n 60 above) paras 52; 59.
62 *College of Estate Management v Customs and Excise Commissioners* [2005] UKHL 62 (thereafter '*College of Estate Management*').
63 *College of Estate Management* (n 62 above) para 12.
64 *Metropolitan International School v Revenue and Customs Commissioners* [2015] UKFTT 517 (TC) (thereafter '*Metropolitan International School*').
65 *Metropolitan International School* (n 64 above) para 66.
66 IS 18/04 (n 54 above) 13 para 55.
67 *CIR v Smiths City Group Ltd* (1992) 14 NZTC 9 140 (HC) 144.

> does it prevent one supply from being ancillary to another supply which for VAT purposes is the dominant supply…[68]

It follows, therefore, that at the end of the inquiry if it is found that the supply is multiple supplies, different VAT rates apply to each part in question. Conversely, if the supply is found to be composite supply, the IS 18/04 states that the last step is to consider if the entire composite supply falls within the below sections;[69]

a) Some supplies of land must be zero-rated—section 11(1) (mb) of the GST Act
b) Other supplies may be partly zero-rated—section 11, 11A, 11AB and 11B.[70]

If these partly zero-rated sections do not apply, the GST treatment of that supply will follow the dominant element of the supply. Importantly, if no dominant component is identifiable, in other words, the composite is made up of several equally essential elements, the GST treatment will be determined by the overall characteristics of a composite supply.[71]

Lastly, the IS 18/04 states that where multiple components are supplied with potentially different VAT treatments, a supplier must determine if a single or composite supply is made. In other words, the supplier must inform the IR whether the supply with several parts constitutes a single or composite supply.

While noting the different legislative context, however, a reasonable conclusion is that the general rule is that each supply is regarded as separate and distinct, a supply that is a composite supply from the economic standpoint (supplier or consumer's point of view) should not be an artificial split, and last, there is a composite supply if one or more parts constitute the dominant part and the remaining ones enhance the enjoyment of the supply.

5 Commentary

The above discussion set out the South African and foreign jurisdiction's approach in deciding if a separate part is made or not. It is noted that South Africa follows the distinct element approach. Fundamentally, this means that each supply is considered as a separate part even if it is supplied in the combined supply.

68 *Customs and Excise Commissioners v British Telecommunication plc* [1999] BTC 5, 273.
69 IS 18/04 (n 54 above) 14 paras 63-67.
70 While these sections provide that some taxable supplies must be zero-rated. According to the IS 18/04, while all zero-rating provisions use 'apply' some provisions indicate that part of the supply can be zero-rated by using the phrase 'to the extent that' or other equivalent wording.
71 IS 18/04 (n 54 above) 15 para 68.

South Africa does not subscribe to the general approach. In determining whether the separate part is made in South Africa, the inquiry is done in terms of section 8(15) and 10(22). If the supply falls under section 8(15), in terms of the *Diageo SA* case, one must clearly determine if all the jurisdictional requirements are present. If the supply falls under section 10(20), as per *Taxpayer v CSARS*, the part that is attributable to the taxable supply is deemed as a separate supply. In terms of section 7(1) of the VAT Act, each supply is treated as a distinct and independent element. As such, the VAT is levied on the supply of goods or supply and importation on the individual supply. Therefore, the rationale in sections 10(22) and 8(15) appears to be based on this reasoning.

The South African distinct element approach to composite supply raises concerns. For instance, the distinct element approach may have a limited application. This is where each part may not be identified as such it cannot be separated.[72] In some cases, even if there is an identifiable part, such part may not constitute an end but merely the means to achieve that end. For example, the illustration A above shows that the taxpayer supplies its customers with two financial investment services. This example shows that in some cases, various parts make up a single supply for tax purposes. If one applies the South African perspective, it is likely these supplies will constitute two independent parts. Arguably, this creates unreal commercial outcomes since each part is deemed to have been supplied individually, thus different rates will apply.

The general approach views this as a supply of a composite service. Foreign jurisdictions apply the last two exceptions to the general rule that each supply is regarded as independent. Therefore, the economic standpoint and features of the composite supply are considered. In the EU and CAN countries where the economic standpoint and features of the supply favour the supply to be treated as a composite supply as opposed to a separate part, the supply is treated as such. In principle, this approach is sound in that it the VAT is levied in the completed supply of goods or services.

South Africa appears to only consider the legal context under sections 8(15) and 10(22) — in determining if a separate part is supplied or not. This approach seems to ignore the economic standpoint as well as features of the supply.[73] Arguably, the distinct element approach applies in South Africa even though other

72 E.g. where the advertising is conducted using digital advertising such as display or video or social media ads, native advertising as well as retargeting and remarketing. In these cases, it is not only difficult to apply the South African composite supply provisions. But it might be tricky and difficult to apply the destination principle. This is because the digital service, especially those provided over the internet, 'can be enjoyed anywhere' including outside the Republic, so to determine the exact place of consumption might be a challenge.

components seem to be ancillary, integral to the identifiable supply. As pointed out in the *Diageo SA* case, each part will be deemed as a separate supply, irrespective of whether the insensible commercial reality outcomes may ensue.[74] It is argued that this approach is very narrow as it fails to consider the essential aspect of the economic standpoint and features of the composite supply.

The ECJ has in several cases that deal with the composite supply emphasised the importance of the last two aspects as follows;

> …consideration of economic and commercial realities is a fundamental criterion for the application of the common system of VAT and that the contractual position normally reflects the economic and commercial reality of the transactions. An exception to the normal rule that the contractual relationship is central was then identified by the court as being where those contractual terms constitute a purely artificial arrangement which does not correspond with the economic and commercial reality of the transactions.[75]

This *dictum* is important since it appears to invite courts not only to consider the legal framework but also consider other fundamentals such as the economic and commercial realities when dealing with the question of composite supply. If it appears from the facts that the tax benefit is the sole reason that prompt the taxpayer to categorise the supply as the composite supply, the court should disregard the above principles. In *Diageo SA* the court correctly pointed out that the purpose of section 8(15) is to curb any avoidance that the taxpayer may take advantage of. By an extension, section 10(22) serves the same purpose. It therefore becomes important for the court to examine whether the taxpayer solely avoids the tax consequences by treating the supply as a composite supply, or it is because of the commercial sensibility.

It is argued that the South African treatment of the composite supply does not accord with the international perspective. This perspective focuses only on the determination of the distinct element of the combined supply. The distinct element approach is incorrect since it presupposes that vendors always make single things for each supply in furtherance of their enterprises. Sometimes various parts make up the supply.[76] The foreign jurisdictions approach arguably reflects the commercial realities that supplies are not always

73 D Kruger & C Moss-Holdstock 'Contract manufacturing: across borders selected South African tax implications' (2016) *Business Tax & Company Law Quarterly* 21-26.

74 *Diageo SA* (n 8 above) paras 16-17.

75 *Tolsma v Inspecteur der Omzetbelasting Leeuwarden* (Case C-16/93) [1994] STC 509 para 14; *Revenue and Customs Commissioner v Loyalty Management UK Ltd and Baxi Group Ltd* (Joined Cases C-53/09 and C-55/09) [2010] STC 265 paras 39, 40; *Revenue and Customs Commissioners v Newey* (Case C-653/11) [2013] STC 2432 para 45; *Airtours Holidays Transport Limited* (n 16 above) para 49.

76 R Sieden & N Apkarian 'GST and apportionment in complex transactions' (2017) 52(2) *The Journal for Members of the Tax institute Taxation in Australia* 68.

classified as single parts but may also be made up of various parts. To reflect this reality, the South African Revenue Services ('SARS') need to provide rules that a taxpayer may use in determining if a separate part is supplied.

6 Recommendations

The paper suggests the recommendations as follows, the new rules for special entities and supplementary notes by the tax authority. The proposals are now discussed.

6.1 Special rule for special entities: Specific anti-avoidance provision

This rule will deem specific entities to have supplied the composite supply, irrespective of the ordinary VAT Act rules. The entities may include but not limited to financial institutions, lawyers, international transport service (see the *British Airways* case), medical practitioners' service unless the supply is independent. This is because these enterprises normally make the supply that is made up of various parts. It is argued that the nature of these enterprise justifies their special treatment. The provision will require a narrow interpretation to avoid the misuse.

6.2 Issuance of interpretation note

SARS notes that '… certainty and predictability are undeniably important in the tax arena.'[77] To enhance certainty in the tax system, SARS may supplement the existing composite supply rules with guidelines. This rule will clarify the SARS position in determine the composite supply. As seen in the CAN countries, SARS may provide step-by-step approach giving the taxpayer on how to determine if a supply is separate part or composite supply for VAT purposes.

7 Conclusion

Admittedly, the purpose of the VAT Act is not to ensure that commercial reality outcomes are achieved. It is rather to impose tax on the supply of goods, service and importation. The manner in which such tax is collected ought to accord with the practical common sense. This requires the consideration of the legal context as well as other fundament aspects when imposing the VAT.

77 SARS Discussion paper on tax avoidance and section 103 of the Income Tax Act 58 of 1962 (2005) 46.

As it stands, it is unclear if the supply that falls outside the *Diageo SA* requirements qualifies as the composite supply or not. It also remains uncertainty whether this approach applies equally to the naturally combined supply and/or combined supply intending to achieve the commercial reality results. It is submitted that the distinct element approach should be retained as the general rule. However, to prevent tax avoidance, artificial split and ensuring the sensible economic and commercial results, there should be an exception or — more determinate rules or guidance is warranted.